

Office of the State Treasurer

Financial Audit

Fiscal Year 1997 Statewide Audit

February 1998

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Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

98-9



STATE OF MINNESOTA
OFFICE OF THE LEGISLATIVE AUDITOR
JAMES R. NOBLES, LEGISLATIVE AUDITOR

Senator Deanna Wiener, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

The Honorable Michael A. McGrath
State Treasurer

We have audited the Office of the State Treasurer for the fiscal year ended June 30, 1997, as further explained in Chapter 1. The work conducted in the Office of the State Treasurer is part of our Statewide Audit of the state of Minnesota's fiscal year 1997 financial statements. The state's Comprehensive Annual Financial Report for the fiscal year ended June 30, 1997, includes our report, issued thereon, dated December 8, 1997. The following Summary highlights the audit objectives and conclusions. We discuss our concerns more fully in the individual chapters of this report.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, as issued by the Comptroller General of the United States. Those standards require that we obtain an understanding of management controls relevant to the audit. The standards require that we design the audit to provide reasonable assurance that the Office of the State Treasurer complied with provisions of laws, regulations, contracts, and grants that are significant to the audit. Management of the Office of the State Treasurer is responsible for establishing and maintaining the internal control structure and complying with applicable laws, regulations, contracts, and grants.

This report is intended for the information of the Legislative Audit Commission and the management of the Office of the State Treasurer. This restriction is not intended to limit the distribution of this report, which was released as a public document on February 27, 1998.

A handwritten signature in cursive script, reading "James R. Nobles".

James R. Nobles
Legislative Auditor

A handwritten signature in cursive script, reading "Claudia J. Gudvangen".

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: January 16, 1998

Report Signed On: February 19, 1998

SUMMARY

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Office of the State Treasurer

Financial Audit

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Public Release Date: February 27, 1998

No. 98-9

Background

The State Treasurer is a constitutional officer elected by the citizens of the state to a four-year term. Michael A. McGrath has served as State Treasurer since January 1987. The Office of the State Treasurer provides banking services for most state agencies. This function includes cash control, receipt processing, and warrant redemption. In addition, the office makes debt service payments on outstanding general obligation bonds and collects various fees and assessments transmitted from county units of government. The State Treasurer also serves as a member of the State Board of Investment, the Minnesota State Retirement System Board, and the Executive Council.

Selected Audit Areas and Conclusions

Our work in the Office of the State Treasurer is completed as part of our annual Statewide Audit. Our audit scope focused on those areas material to the state of Minnesota's financial statements, including state depository cash control and debt service expenditures. In addition, we expanded our audit scope beyond Statewide Audit objectives to review Office of the State Treasurer revenue collections and administrative expenditures for fiscal year 1997.

We concluded that internal controls over the areas reviewed provide reasonable assurance that assets were adequately safeguarded and that transactions were authorized and properly reported in the accounting records. We also concluded that the office complied with material legal provisions related to the areas reviewed. However, the Office of the State Treasurer needs to provide for the appropriate disposition of unused frequent flyer benefits.

The State Treasurer's response to the audit report is included in the report.

Office of the State Treasurer

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Audit Participation

The following members of the Office of the Legislative Auditor prepared this report:

Claudia Gudvangen, CPA	Deputy Legislative Auditor
Tony Toscano	Auditor-in-Charge
Terry Hanson	Auditor
Chege Ngigi	Auditor
Susan O'Connell	Auditor
Laura Peterson, CPA	Auditor
Jason Stauffenecker	Auditor
Rick Weinmeyer	Auditor
Keith Bispala	Intern

Exit Conference

We discussed the results of the audit with the following staff of the Office of the State Treasurer at an exit conference on February 11, 1998:

Michael A. McGrath	State Treasurer
John Manahan	Deputy State Treasurer
Jerry Engebretson	Director of Treasury Operations

Chapter 1. Introduction

The State Treasurer is a constitutional officer elected by the citizens of the state to a four-year term. Michael A. McGrath has served as State Treasurer since January 1987. The State Treasurer also serves as a member of the State Board of Investment, the Minnesota State Retirement System Board, and the Executive Council.

Our work in the Office of the State Treasurer is completed as part of our annual Statewide Audit. The primary objective of the Statewide Audit is to render an opinion on the state of Minnesota's financial statements included in its Comprehensive Annual Financial Report for fiscal year 1997. This includes determining whether the financial statements of the state present fairly its financial position, results of operations, and changes in cash flows in conformity with generally accepted accounting principles. As part of our work, we are required to gain an understanding of the internal control structure and ascertain whether the state complied with laws and regulations that may have a material effect on its financial statements.

The state's Comprehensive Annual Financial Report for the fiscal year ended June 30, 1997, includes our unqualified audit opinion issued thereon, dated December 8, 1997. The Minnesota Financial and Compliance Report on Federally Assisted Programs for the fiscal year ended June 30, 1997, will include our reports on the supplementary information schedule of federal expenditures, the state's internal control structure, and compliance with laws and regulations. We anticipate issuing that report in March 1998.

Our financial statement audit scope focused on the State Treasurer's responsibilities in the following areas that were material to the state's financial statements in the fiscal year ended June 30, 1997:

- state depository cash control, including receipt collections and warrant redemptions, and
- debt service expenditures.

In addition to the statewide audit scope, we reviewed other financial activities administered by the Office of the State Treasurer in fiscal year 1997. Our audit scope included the following areas:

- fee and surcharge revenue,
- banking fee expenditures,
- payroll, and
- out-of-state travel expenditures.

To address our financial statement and agency objectives, we interviewed key agency employees, reviewed applicable policies and procedures, tested representative samples of financial transactions, and performed analytical procedures, as appropriate. Our specific audit work is discussed more fully in the following chapters.

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Chapter 2. Cash Control

Chapter Conclusions

The Office of the State Treasurer designed state depository internal controls to provide reasonable assurance that cash was adequately safeguarded and that transactions were authorized and properly reported in the accounting records. The cash balance recorded on the State Treasurer's records was supported by the underlying transactions and bank account records. In addition, the Office of the State Treasurer materially complied with applicable legal provisions relating to cash transactions tested.

The Office of the State Treasurer provides banking services for most state agencies. The office interacts with the Department of Finance, which provides accounting and other services, and the State Board of Investment, which invests state monies. The office accounts for money deposited by state agencies in the state treasury until it is lawfully disbursed or invested. Receipt transactions, including investment redemptions and maturities, totaled \$19.5 billion in fiscal year 1997.

The State Treasurer maintains approximately 300 accounts in over 150 banks throughout the state. The total cash balance for state accounts, as recorded on the State Treasurer's records at June 30, 1997, was over \$84 million. The office works with state agencies to resolve any discrepancies between accounting and bank records.

Another function of the office is to verify and redeem state warrants used by state agencies to satisfy lawful obligations of the state. The Office of the State Treasurer determines that the items submitted by the banks are valid, outstanding warrants before transferring funds to the banks for payment. The Treasurer also maintains records detailing the daily balance of outstanding warrants. During fiscal year 1997, the Treasurer's Office processed warrants totaling approximately \$13.6 billion. In addition, the office initiated \$5.1 billion of automatic clearing house transactions based on Department of Finance and other state agency authorizations.

The Office of the State Treasurer monitors collateral pledged to secure funds deposited in the various state depository accounts. Pursuant to statutory requirements, state deposits cannot exceed 90 percent of the market value of the collateral pledged by the bank. The State Treasurer's system monitors the collateral balance and identifies when insufficient coverage exists. As of June 30, 1997, banks pledged \$102 million in collateral to secure depository accounts.

Office of the State Treasurer

The primary objectives of our audit were to answer the following questions:

- Did the Office of the State Treasurer design internal controls to provide reasonable assurance that cash was adequately safeguarded and that transactions were authorized and properly reported in the accounting records?
- Is the cash balance reported on the Office of the State Treasurer's accounting records supported by bank account records?
- Did the Office of the State Treasurer comply with material legal provisions in administering state depository accounts?

To address our financial statement objectives, we interviewed key department employees to gain an understanding of applicable policies and procedures. We confirmed bank balances and tested the State Treasurer's bank account reconciliations. In conjunction with our audit of the Department of Finance, we reviewed and tested supporting documentation for reconciliations of cash receipt and disbursement transactions recorded on the Minnesota Accounting and Procurement System (MAPS) and the State Treasurer's depository accounting system. We reviewed the controls over warrant and automatic clearing house transactions and verified the reconciliation of outstanding warrants as recorded on MAPS to the State Treasurer's outstanding warrant balance at June 30, 1997. We also tested compliance with Minn. Stat. Section 9.031, pertaining to the adequacy of collateral coverage.

We concluded that the Office of the State Treasurer designed state depository internal controls to provide reasonable assurance that cash was adequately safeguarded and that transactions were authorized and properly reported in the accounting records. The cash balance recorded on the State Treasurer's records was supported by the underlying transactions and bank account records. In addition, the Office of the State Treasurer materially complied with applicable legal provisions relating to cash transactions tested.

Chapter 3. Debt Service Expenditures

Chapter Conclusions

The Office of the State Treasurer designed internal controls over general obligation bond debt service payments to provide reasonable assurance that expenditures were accurate and properly reported in the accounting records. The office appropriately paid \$288 million in principal and interest on general obligation bonds during fiscal year 1997. The Office materially complied with applicable legal provisions for debt service payments tested.

As provided in the State Constitution, the State Treasurer maintains records and makes payments for principal and interest on the state's general obligation bonds. At June 30, 1997, the outstanding general obligation bonds payable totaled \$2.16 billion. During fiscal year 1997, the State Treasurer made debt service payments totaling approximately \$288 million.

The primary objectives of our audit were to answer the following questions:

- Did the Office of the State Treasurer design internal controls to provide reasonable assurance that debt service expenditures were authorized and properly reported in the accounting records?
- Did debt service payments comply with applicable amortization schedules and other material legal provisions?

To address our financial statement objectives, we interviewed key department employees to gain an understanding of applicable policies and procedures and performed analytical procedures, as appropriate. In addition, we verified the debt service payments to the amortization schedules prepared by the Department of Finance.

We concluded that the Office of the State Treasurer designed internal controls over general obligation bond debt service payments to provide reasonable assurance that expenditures were accurate and properly reported in the accounting records. The Office of the State Treasurer appropriately paid \$288 million in principal and interest on general obligation bonds during fiscal year 1997. The office materially complied with applicable legal provisions for debt service payments tested.

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Chapter 4. Revenue

Chapter Conclusions

The Office of the State Treasurer designed internal controls over the receipt process to provide reasonable assurance that all revenue was collected and properly reported in the accounting records. The fiscal year 1997 revenue collections that we tested materially complied with applicable legal provisions.

The Office of the State Treasurer collects various fees, fines, and assessments. Substantially all of the receipts are transmitted by county governments that collect the amounts in accordance with various statutory provisions. The Office of the State Treasurer deposits the majority of the receipts in the General Fund as nondedicated revenue. Table 4-1 shows the revenue collected by the Office of the State Treasurer during fiscal year 1997.

Table 4-1
Summary of Revenue
Fiscal Year 1997

	<u>Amount</u>	<u>Percent</u>
Civil and Probate Fees	\$13,748,306	29.2
Petty and Gross Misdemeanor Fees	8,967,351	19.0
Officer Training Surcharge	5,535,788	11.7
Land Recording and Registration Surcharge	4,917,506	10.4
Court Fines	3,416,503	7.2
Marriage License	1,716,143	3.6
Chemical Related Fines	1,696,974	3.6
Court Filing and License Fees	1,694,755	3.6
Victims and Assault Surcharge	1,554,602	3.3
Bail Forfeits	989,352	2.1
Seat Belt and Highway Work Zone Fines	879,586	1.9
Birth Certificate Surcharge	539,126	1.2
Public Defender Reimbursements	199,934	0.4
Other	<u>1,317,569</u>	<u>2.8</u>
Total	<u>\$47,173,495</u>	<u>100.0</u>

Source: Minnesota Accounting and Procurement System.

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The primary objectives of our audit of revenue were to address the following questions:

- Did the Office of the State Treasurer design internal controls to provide reasonable assurance that the appropriate amount of revenue was collected and properly reported in the accounting records?
- Did revenue collections comply with applicable financial legal provisions?

The methodology we used to audit revenue included interviewing key agency employees to gain an understanding of applicable policies and procedures, testing receipt transactions and supporting documentation, including county remittance reports, and performing analytical procedures, as determined appropriate.

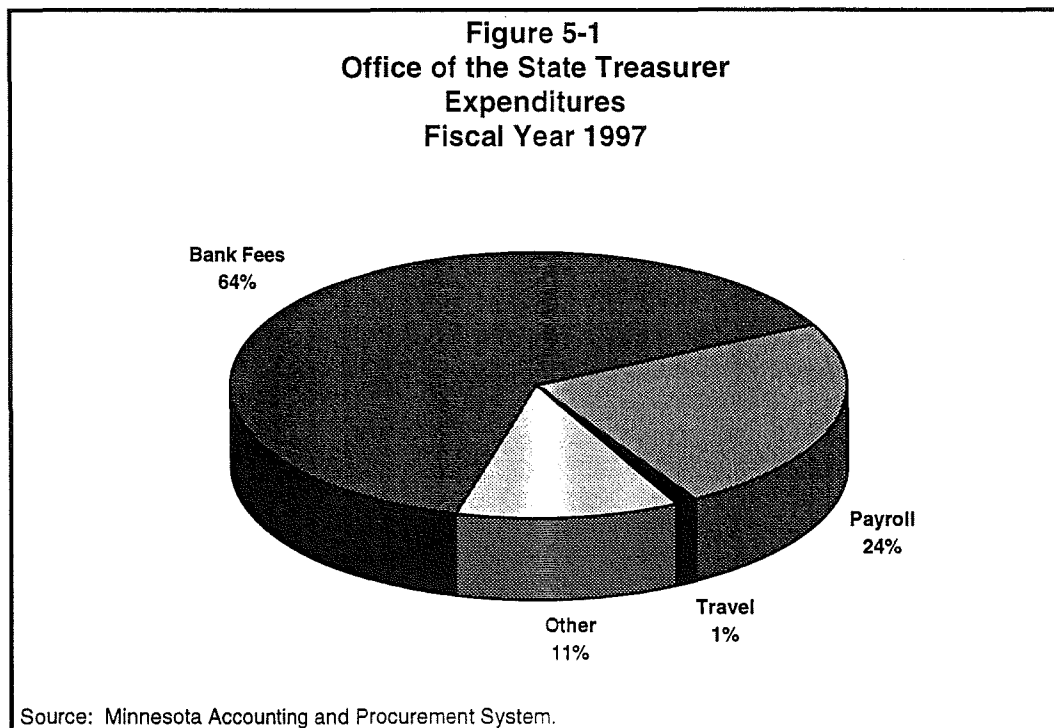
We concluded that the Office of the State Treasurer designed internal controls over the receipt process to provide reasonable assurance that revenue was collected and properly reported in the accounting records. Fiscal year 1997 revenue collections that we tested materially complied with applicable legal provisions and were properly deposited and recorded.

Chapter 5. Administrative Expenditures

Chapter Conclusions

The Office of the State Treasurer designed and implemented internal controls to provide reasonable assurance that payroll and other administrative expenditures were properly authorized, adequately supported, and accurately processed. The Office of the State Treasurer complied with material finance-related legal provisions. However, the Office of the State Treasurer needs to address the use of frequent flyer miles earned by the State Treasurer.

The Office of the State Treasurer expended approximately \$2.6 million during fiscal year 1997. Figure 5-1 shows the office's expenditures by category.



As shown in the graphic, bank fees, which totaled \$1,663,833, was the largest expenditure category. The State Treasurer has statutory authority to pay depositories for performing banking services relating to the deposit of state funds. The State Treasurer makes payments based on contracts with local depositories. Payroll, which amounted to \$623,818, was the next largest category. The Office of the State Treasurer had 13 staff positions during fiscal year 1997. All payroll was processed through the state payroll system.

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We focused our review of administrative expenditures on the following objectives:

- Did the Office of the State Treasurer design and implement internal controls to provide reasonable assurance that bank fees and payroll expenditures were properly authorized, adequately supported, and properly recorded in the accounting records?
- Did the Office of the State Treasurer comply with material finance-related legal provisions and applicable bargaining unit agreements?

The audit methodology used to review these areas included interviewing key agency employees to gain an understanding of the controls over payroll and bank fee expenditures. We reviewed supporting documentation and performed analytical procedures, as determined appropriate, for a sample of transactions to determine if they were properly authorized, processed, and recorded. We also reviewed expenditures to determine if the Office of the State Treasurer complied with material finance-related legal provisions.

We concluded that the Office of the State Treasurer designed internal controls to provide reasonable assurance that payroll and bank fee expenditures were accurately reported in the accounting records. In addition, the office was in compliance with material finance-related legal provisions with respect to the items tested.

Out-of-State Travel

During the course of our audit fieldwork, questions arose about the State Treasurer's out-of-state travel expenditures. We expanded our review of administrative expenditures to focus on the following question:

- Did the State Treasurer's out-of-state travel expenditures serve a public purpose and comply with applicable policies and procedures?

We reviewed supporting documentation for all fiscal year 1997 out-of-state travel expenditures incurred by the state of Minnesota on behalf of the State Treasurer. Our review considered whether the amounts claimed for reimbursement were allowable, properly documented, and accurately processed. We also reviewed documentation regarding the purpose of each trip to ensure that the travel was for a public purpose. Table 5-1 summarizes the trips taken by the State Treasurer during fiscal year 1997.

We also reviewed the use of frequent flyer mileage benefits. Frequent flyer benefits are accruing in the name of the current state treasurer and statements are sent to his home address. However, copies of all frequent flyer statements were on file in the Office of the State Treasurer. Frequent flyer benefits were used once during fiscal year 1997 to purchase a ticket for travel relating to state business.

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Table 5-1
State Treasurer's Out-of-state Travel Expenditures
Fiscal Year 1997

Organization	Purpose	Trips	Days	Net Cost To State
National Association of State Treasurers (NAST)	Meetings/Conferences	9	32	\$ 4,675
National Association of State Auditors, Controllers, and Treasurers (NASACT)	Meetings/Conferences	5	25	5,850
Council of Institutional Investors (CII)	Meetings/Conferences	4	14	4,717
Council of State Governments (CSG)	Meetings/Conferences	2	8	678
Electronic Benefits Council (EBT)	Meetings/Conferences	1	5	546
Institute for International Research	Speaker	1	8	1,183
Public Funds Board Summit	Speaker	1	4	590
Pacific Rim Pension Funds	Speaker	1	3	804
Center for Policy Alternatives	Meetings/Conferences	3	8	3,422
Other	Education/Training	<u>6</u>	<u>20</u>	<u>5,952</u>
Total		<u>33</u>	<u>127</u>	<u>\$28,417</u>

Note 1: During fiscal year 1997, the State Treasurer served as president of NAST, was on the executive committee of NASACT and CSG, was a board member of EBT, and a co-chair of CII.

Note 2: The number of days shown represents actual days in travel status, including weekends. The total includes 87 regular work days (M-F), 39 weekend days, and one state holiday.

Note 3: A portion of the total expenditures for the State Treasurer's out-of-state travel was paid by the State Board of Investment in accordance with an established policy providing training funds to board members.

Note 4: The cost amount shown is net of any reimbursements by sponsoring organizations.

Source: MAPS accounting reports and Office of the State Treasurer supporting records.

A significant portion of the State Treasurer's travel is a result of his involvement in various national organizations related to his position. Mr. McGrath's participation in the work of national organizations has been significantly more extensive than that of previous State Treasurers. During a portion of fiscal year 1997 (July to November 1996), Mr. McGrath served as president of the National Association of State Treasurers (NAST). For the remainder of the fiscal year, he served on the organization's executive committee. Mr. McGrath also served on the governing boards or other committees of several other organizations. His involvement with some of these groups was directly related to his positions with NAST. In some cases, the sponsoring organization reimbursed the state for all or a portion of Mr. McGrath's travel expenditures.

We concluded the following from our review of the State Treasurer's out-of-state travel:

- During fiscal year 1997, the out-of-state travel expenditures incurred by the state on behalf of State Treasurer McGrath complied with applicable policies and procedures.

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- Individually, the various meetings and conferences the State Treasurer attended would pass the test of serving a public purpose. Involvement in national organizations and attendance at educational sessions is not unique to the Office of the State Treasurer. Other state agencies also participate in national events directly related to their work program or for staff development. What is somewhat unique is the number of events the State Treasurer personally participated in. Except for some limited travel by the Deputy State Treasurer, the State Treasurer personally incurred the office's out-of-state travel expenditures. Other agencies often have various staff members attend educational events or participate in national organizations.
- The State Treasurer has a great deal of discretion in determining how to accomplish the duties of his office. There are no requirements that he spend a specific amount of time in his office in the Capitol Complex. The State Treasurer can assign various duties to his staff rather than perform them personally. Ultimately, the State Treasurer, and the other Constitutional Officers, are responsible to the voters of the state.

From our review of travel expenditures, we identified one issue related to travel, as described in Finding 1, that the Office of the State Treasurer should address.

1. The Office of the State Treasurer needs to provide for the appropriate disposition of unused frequent flyer benefits.

The Office of the State Treasurer needs to address how any unused frequent flyer benefits accumulated by the current state treasurer will be handled when he leaves office. The current State Treasurer accumulates frequent flyer benefits in his personal account while traveling at state expense. Frequent flyer program guidelines require the mileage earned on flights to be credited to the account of the person taking the flight. The Office of the State Treasurer generally used these benefits to purchase tickets for shorter business trips when advance reservations were not possible. Although there is no requirement for state employees to accumulate frequent flyer benefits, Minn. Laws 1992, Chapter 592, Section 20, provides in part that:

Whenever public funds are used to pay for airline travel by an elected official or public employee, any credits or other benefits issued by any airline must accrue to the benefit of the public body providing the funding.

It is questionable whether or not frequent flyer benefits can be transferred from one account to another. An account holder can use benefits to purchase a ticket for another individual, but tickets are transmitted to the account holder. State Treasurer McGrath has stated that he does not intend to run for reelection. Any benefits earned by the State Treasurer while traveling at state expense should accrue to the office.

Recommendation

- *The Office of the State Treasurer should determine necessary actions to ensure that any remaining frequent flyer benefits are used for state business.*



STATE OF MINNESOTA
OFFICE OF STATE TREASURER

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MICHAEL A. McGRATH
Treasurer

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February 18, 1997

James R. Nobles
Legislative Auditor
and
Claudia Gudvangen
Deputy Legislative Auditor
Veterans Service Building
St. Paul, Minnesota 55155

Dear Mr. Nobles and Ms. Gudvangen:

Thank you for the opportunity to respond to the comment and recommendations in your financial audit report for the year ended June 30, 1997. Our response is attached.

We appreciate your assistance and recommendation. Your staff conducted itself in a very responsible and professional manner during the entire process.

As always, we are available for further discussions to improve the operation of the Office of the State Treasurer.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael McGrath".

Michael A. McGrath
Treasurer
State of Minnesota

RESPONSE OF THE OFFICE OF THE STATE TREASURER

TO

LEGISLATIVE AUDITOR RECOMMENDATIONS

FOR

THE YEAR ENDED JUNE 30, 1997

Auditor's Recommendation #1

The Office of State Treasurer should determine necessary actions to ensure that any remaining frequent flyer benefits are used for state business.

State Treasurer's Response

The Office of State Treasurer enrolled in the frequent flyer program to take advantage of potential savings. In so doing, the frequent flyer account must be in the personal name of the State Treasurer. The Legislative Auditor is concerned that the miles earned are not transferable and, therefore, when the current State Treasurer leaves office, the miles cannot be transferred to the incoming State Treasurer. We have been assured that these miles are transferable and are available for state business in the future. We have asked the airline to confirm this in writing for our files.