Office of the State Treasurer

Financial Audit
Fiscal Year 1998 Statewide Audit

March 1999

Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

99-16

Centennial Office Building, Saint Paul, MN 55155 • 651/296-4708

SUMMARY

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Office of the State Treasurer

Financial Audit
Fiscal Year 1998 Statewide Audit

Public Release Date: March 12, 1999 No. 99-16

Background

The State Treasurer is a constitutional officer elected by the citizens of Minnesota to a four-year term. Michael A. McGrath served as State Treasurer from January 1987 until January 1999. On January 4, 1999, Carol Johnson was sworn in as the new State Treasurer. During the November 1998 elections, the voters of Minnesota approved a constitutional amendment abolishing the Office of the State Treasurer effective at the conclusion of Carol Johnson's current four-year term. 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 the 87 counties. 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 the Office of the State Treasurer's revenue collections and administrative expenditures for the period July 1, 1997, to December 31, 1998.

We qualified our report, dated December 1, 1998, on the State of Minnesota's Comprehensive Annual Financial Report because insufficient audit evidence exists to support the State of Minnesota's disclosures with respect to the year 2000. Auditing the state's year 2000 compliance efforts was not an objective of this audit. As a result, we do not provide assurance that the Office of the State Treasurer is or will be year 2000 ready, that its year 2000 remediation efforts will be successful in whole or in part, or that parties with which the Office of the State Treasurer does business will be year 2000 ready. We concluded that internal controls over the areas reviewed provide reasonable assurance that assets were adequately safeguarded, and 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, except that the Office of the State Treasurer needs to improve controls over travel costs.

The Office of the State Treasurer agreed with our recommendation and will take corrective action to resolve the situation.

STATE OF MINNESOTA

OFFICE OF THE LEGISLATIVE AUDITOR

JAMES R. NOBLES, LEGISLATIVE AUDITOR

Representative Dan McElroy, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

The Honorable Carol Johnson
State Treasurer

We have audited the Office of the State Treasurer for the fiscal year ended June 30, 1998, 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 1998 financial statements. We qualified our report, dated December 1, 1998, on the State of Minnesota’s general purpose financial statements because insufficient audit evidence exists to support the State of Minnesota’s disclosures with respect to the year 2000. Auditing the state’s year 2000 compliance efforts was not an objective of this audit. As a result, we do not provide assurance that the Office of the State Treasurer is or will be year 2000 ready, that its year 2000 remediation efforts will be successful in whole or in part, or that parties with which the Office of the State Treasurer does business will be year 2000 ready.

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.

We prepared this report for the information of the Legislative Audit Commission and the management of the Office of the State Treasurer. However, we do not limit the distribution of this report, which was released as a public document on March 12, 1999.

James R. Nobles
Legislative Auditor

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: February 5, 1999

Report Signed On: March 8, 1999

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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
Cecile Ferkul, CPA, CISA	Audit Manager
Tony Toscano	Auditor-in-Charge
Laura Peterson, CPA	Auditor
Terry Hanson, CPA	Auditor
Neal Dawson	Auditor
Crystal Eskridge	Auditor
Rick Weinmeyer	Auditor
Dan Kingsley	Auditor

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 25, 1999:

Carol Johnson	State Treasurer
John Manahan	Deputy State Treasurer
Jerry Engebretson	Director of Treasury Operations

Chapter 1. Background

The State Treasurer is a constitutional officer elected by the citizens of Minnesota to a four-year term. Michael A. McGrath served as State Treasurer from January 1987 until January 1999, when Carol Johnson was sworn in as the new State Treasurer. 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 was to render an opinion on the State of Minnesota's financial statements included in its Comprehensive Annual Financial Report for fiscal year 1998. This included determining whether the financial statements of the state presented 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 were 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.

We qualified our report, dated December 1, 1998, on the State of Minnesota’s Comprehensive Annual Financial Report because insufficient audit evidence exists to support the State of Minnesota’s disclosures with respect to the year 2000. Auditing the state’s year 2000 compliance efforts was not an objective of this audit. As a result, we do not provide assurance that the Office of the State Treasurer is or will be year 2000 ready, that its year 2000 remediation efforts will be successful in whole or in part, or that parties with which the Office of the State Treasurer does business will be year 2000 ready. We concluded that internal controls over the areas reviewed provide reasonable assurance that assets were adequately safeguarded, and 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, except that the Office of the State Treasurer needs to improve controls over travel costs.

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, 1998:

- 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 for the period July 1, 1997 to December 31, 1998. Our audit scope included the following areas:

- revenue,
- bank fees,
- payroll, and
- travel.

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.

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, for the items tested, the Office of the State Treasurer complied with applicable legal provisions.

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 $21.8 billion in fiscal year 1998.

Another function of the office is to verify and redeem state warrants used by state agencies to satisfy lawful obligations of the state. The Treasurer's Office determines that the items submitted by the banks are valid outstanding warrants before transferring funds to the banks for payment. The Treasurer’s Office also maintains records detailing the daily balance of outstanding warrants. During fiscal year 1998, the Treasurer's Office processed warrants totaling approximately $13 billion. In addition, the office initiated $6.3 billion 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. At June 30, 1998, banks pledged $80.1 million in collateral to secure depository accounts.

Audit Objectives and Methodology

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 transactions were authorized and properly reported in the accounting records?

Office of the State Treasurer

- Was 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 at June 30, 1998, and December 31, 1998, 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, 1998. We also tested compliance with Minn. Stat. Section 9.031, pertaining to the adequacy of collateral coverage.

Conclusions

State depository internal controls provide reasonable assurance that cash was adequately safeguarded, and 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, for the items tested, the Office of the State Treasurer materially complied with applicable legal provisions.

Chapter 3. Debt Service Expenditures

Chapter Conclusions

Internal controls over general obligation bond debt service payments provide reasonable assurance that expenditures are accurate and properly reported in the accounting records. The Office of the State Treasurer appropriately paid $300 million in principal and interest on general obligation bonds during fiscal year 1998. For the items tested, the Office of the State Treasurer complied with applicable legal provisions for debt service payments.

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, 1998, the outstanding general obligation bonds payable totaled $2.51 billion. During fiscal year 1998, the State Treasurer made debt service payments totaling approximately $300 million.

Audit Objectives and Methodology

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.

Conclusions

Internal controls over general obligation bond debt service payments provide reasonable assurance that expenditures are accurate and properly reported in the accounting records. The Office of the State Treasurer appropriately paid $300 million in principal and interest on general obligation bonds during fiscal year 1998. The Office materially complied with applicable legal provisions for debt service payments.

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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 is collected and properly reported in the accounting records. For the revenue collections that we tested, the Office of the State Treasurer 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 non-dedicated revenue. Table 4-1 shows the receipts collected by the Office of the State Treasurer during the period July 1, 1997, to December 31, 1998.

Table 4-1
Summary of Receipts
July 1, 1997, to December 31, 1998

	Amount	Percent
Civil and Probate Filing Fees	$21,075,210	27
Petty and Gross Misdemeanor Fees	15,364,139	20
Officer Training Surcharge	9,242,774	12
Land Recording and Registration Surcharge	8,431,127	11
Court Fines and Fees	7,004,995	9
Marriage License Fees	2,897,312	4
Birth/Death Certificate Copy Surcharge	2,463,739	3
Victims Services Surcharge	2,362,172	3
Assault Fines and Criminal Charge Surcharge	1,924,791	2
Bail Forfeits	1,695,180	2
Seat Belt and Highway Work Zone Fines	1,586,401	2
Chemical Related Fines	1,250,687	2
Tax Increment Administrative Fees	889,830	1
Escrow Interest	688,526	1
Public Defender Reimbursements	325,015	0
Other	446,828	1
Total	$77,648,726	100%

Source: Minnesota Accounting and Procurement System.

Office of the State Treasurer

Audit Objectives and Methodology

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.

Conclusions

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. The revenue collections that we tested complied with applicable legal provisions and were properly deposited and recorded.

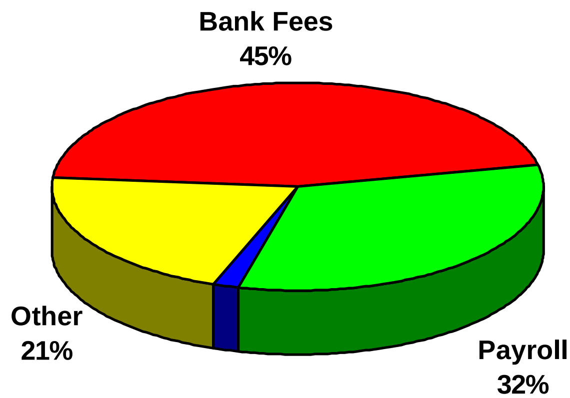
Chapter 5. Administrative Expenditures

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, except that the Office of the State Treasurer needs to take steps to ensure that all expenses paid for by the state are allowable under state travel regulations.

The Office of the State Treasurer expended approximately $3.1 million during the period July 1, 1997, to December 31, 1998. The two major expenditure types were bank fees and payroll which totaled $1,402,727 and $996,006 respectively. Figure 5-1 shows the office's major expenditure categories.

Figure 5-1
Office of the State Treasurer
Expenditures
July 1, 1997, to December 31, 1998



Source: Minnesota Accounting and Procurement System.

The State Treasurer has statutory authority to pay depositories for performing banking services relating to the deposit of state funds. The office makes payments based on contracts with local depositories. The Office of the State Treasurer employed 14 individuals during the time period covered by our audit. All payroll is processed through the state payroll system.

Office of the State Treasurer

Audit Objectives and Methodology

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, payroll, and travel 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 and travel expenditures. We reviewed supporting documentation and performed analytical procedures as determined appropriate, for a sample of payroll, bank fee, and travel expenditure 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.

Conclusions

The Office of the State Treasurer designed and implemented internal controls to provide reasonable assurance that payroll and bank fee expenditures were accurately reported in the accounting records. We also concluded that the Office of the State Treasurer was in compliance with material finance-related legal provisions with respect to the items tested, except as described in Finding 1. The Office of the State Treasurer needs to take steps to ensure that all expenses paid for by the state are allowable under state travel regulations.

1. The Office of the State Treasurer needs to improve controls over travel costs.

The Office of the State Treasurer needs to ensure that all travel costs are allowable under state regulations. The Office of the State Treasurer spent $48,445 on travel from July 1, 1997, to December 31, 1998; all but $834 was due to out-of-state travel. We examined the supporting documentation for a sample of these transactions. We question the reasonableness of the travel expenses related to one out-of-state trip and some telephone costs incurred on that and another trip.

On Monday and Tuesday, October 5 and 6, 1998, the former State Treasurer, Michael McGrath, attended the Council of Institutional Investors Fall Conference in New York. Mr. McGrath flew from Minneapolis to New York on Saturday October 3. The airfare for the trip was $510. The transaction's support did not document whether it was more economical to fly on Saturday rather than Sunday. Mr. McGrath did not stay at the conference hotel; instead he chose to stay at a similarly rated, nearby hotel. Mr. McGrath stated that he chose a different hotel because he had previously received poor service at the conference hotel. The preferred room rate at the conference hotel was $280 per night. Mr. McGrath stated that he learned upon checkout that the room rate at the hotel he stayed in was $450 per night. The total cost for the room for four nights, including applicable taxes, was $2,045, approximately $750 more than staying at the conference hotel would have cost.

The Commissioners Plan, which establishes the State Treasurer's benefit provisions, requires employees to exercise good judgement in incurring lodging costs that are reasonable and consistent with the facilities available. State policy requires that agencies prepare an out-of-state travel authorization form to document travel decisions that have a financial impact, such as hotel choices and airfare rates. If the State Treasurer's Office had used this form, it would have documented answers to questions we had about this trip and allowed the office to evaluate in advance the decision to stay at the higher priced hotel.

Additionally, two hotel charges included large phone costs. On the four-day stay in New York, the former State Treasurer's hotel bill included $131 in local phone charges. In another instance, on a five-day trip to Boston, the hotel bill included charges for 104 local phone calls at $1 per call. Staff in the State Treasurer's Office indicated that they believed the charges related to the Mr. McGrath's use of a personal computer to check on e-mail.

Recommendation

- *To ensure that all state paid travel costs are reasonable and allowable, the Office of the State Treasurer needs to properly document all financial decisions related to out-of-state travel.*

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Status of Prior Audit Issues
As of February , 1999

Most Recent Audit

February 19, 1998, Legislative Audit Report 98-9 focused on selected state programs as part of the Statewide Financial Audit. The audit covered areas material to the State of Minnesota's financial statements, including state depository cash control and debt service expenditures in fiscal year 1997. The report contained one finding related to the disposition of unused frequent flyer benefits. The department implemented the recommendation discussed in the audit.

State of Minnesota Audit Follow-Up Process

The Department of Finance, on behalf of the Governor, maintains a quarterly process for following up on issues cited in financial audit reports issued by the Legislative Auditor. The process consists of an exchange of written correspondence that documents the status of audit findings. The follow-up process continues until Finance is satisfied that the issues have been resolved. It covers entities headed by gubernatorial appointees, including most state agencies, boards, commissions, and Minnesota state colleges and universities. It is not applied to audits of the University of Minnesota and quasi-state organizations, such as the metropolitan agencies or the State Agricultural Society, the state constitutional officers, or the judicial branch.

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CAROL C. JOHNSON
MINNESOTA
STATE TREASURER

March 4, 1999

James R. Nobles
Legislative Auditor
and
Claudia Gudvangen
Deputy Legislative Auditor
First Floor South Centennial Building
658 Cedar Street
St. Paul, MN 55155

Dear Mr. Nobles and Ms. Gudvangen:

Thank you for this opportunity to respond to the comment and recommendations in your financial audit report for the period July 1, 1997 to December 31, 1998. Our response is attached.

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

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

Sincerely,

Carol C. Johnson

Carol C. Johnson
Treasurer
State of Minnesota

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RESPONSE OF THE OFFICE OF THE STATE TREASURER

TO

LEGISLATIVE AUDITOR RECOMMENDATIONS

FOR THE PERIOD JULY 1, 1997 TO DECEMBER 31, 1998

Auditor's Recommendation #1

To ensure that all state paid travel costs are reasonable and allowable, the Office of the State Treasurer needs to properly document all financial decisions related to out-of-state travel.

State Treasurer's Response

The State Treasurer concurs with the findings and recommendation of the Legislative Auditor. When the possibility exists that expenses could be out of the ordinary, such as an employee staying at a hotel different from the designated conference hotel, we will document and evaluate those expenses prior to incurring them.

You express concern about the number of local telephone calls made from Mr. McGrath's hotel room. It is not clear what criteria should be applied in determining reasonableness. In this day of expanding use of telecommunications to remain connected to the office, it is difficult to establish hard and fast rules for reasonable expenses. Mr. McGrath used the telephone and Internet connectivity as his primary method of conducting business while traveling. Frequent Internet connections, including the inevitable reconnecting following disconnects, may result in increased amount of telephone usage. Nevertheless, we will provide documentation when we feel that the number of local telephone calls seem excessive.