Department of Finance

Statewide Audit – Selected Audit Areas
For the Year Ended June 30, 1998

March 1999

Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

99-18

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

SUMMARY

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Department of Finance

Statewide Audit - Selected Audit Areas
For the Year Ended June 30, 1998

Public Release Date: March 12, 1999 No. 99-18

Background Information

The Department of Finance maintains the state's accounting system and manages its accounting, budgetary, and debt management activities. It establishes policies and procedures to ensure consistent and reliable financial data and compliance with statutory provisions. The department is also responsible for the fairness, accuracy and completeness of the State of Minnesota's Comprehensive Annual Financial Report. Wayne Simoneau was commissioner during the time period covered by our audit. Pamela Wheelock became commissioner on February 10, 1999.

Selected Audit Areas and Conclusions

Our audit scope was limited to those activities material to the State of Minnesota's general purpose financial statements for the year ended June 30, 1998. Our primary audit objective was to render an opinion on the State of Minnesota's financial statements. We also examined some administrative functions over federal funds performed by the department. Our scope within the Department of Finance included:

- general obligation bond sales;
- debt service transfers;
- master lease program;
- municipal energy loans;
- appropriation transfers to the University of Minnesota;
- federal cash management; and
- statewide indirect costs.

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 Department of Finance 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 Department of Finance does business will be year 2000 ready.

For the areas audited, the Department of Finance's financial activities were fairly presented in the general purpose financial statements of the State of Minnesota's Comprehensive Annual Financial Report for the year ended June 30, 1998. For the areas tested, the department complied, in all material respects, with the federal requirements relating to cash management and indirect costs, as described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement. However, the department needs to improve its oversight of agencies preparing financial statement data and its controls over the distribution of Invested Treasurers Cash earnings. The department also did not cancel outstanding warrants in accordance with statutory requirements.

In its response, the Department of Finance agreed with the report's findings and recommendations and is taking corrective actions to resolve the issues.

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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
Dan Kingsley	Auditor
Rick Weinmeyer	Auditor

Exit Conference

The findings and recommendations in this report were discussed with the following officials of the Department of Finance at an exit conference held on March 1, 1999:

Pamela Wheelock	Commissioner
Don Smith	Acting Assistant Commissioner
Margaret Jenniges	Financial Reporting Director
Mary Bogie	Agency Support Director
Barb Ruckheim	Financial Reporting Supervisor
Ron Mavetz	General Ledger Supervisor

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

Ms. Pamela Wheelock, Commissioner
Department of Finance

We have performed certain audit procedures at the Department of Finance as part of our audit of the financial statements of the State of Minnesota as of and for the year ended June 30, 1998. We also have audited certain federal financial assistance functions administered by the Department of Finance as part of our audit of the state's compliance with certain federal requirements. These requirements, relating to cash management and indirect costs, are described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* and are applicable to major federal programs for the year ended June 30, 1998. We emphasize that this has not been a comprehensive audit of the Department of Finance.

The bullets below identify the financial activities within the Department of Finance that were material to the state's financial statements. We performed certain audit procedures on these Department of Finance programs as part of our objective to obtain reasonable assurance about whether the State of Minnesota's financial statements for the year ended June 30, 1998, were free of material misstatement.

- The cash and debt management division coordinates the sale of state general obligation bonds, used mainly to finance state building construction and repair. New bond issues in fiscal year 1998 were over $531 million.

- The cash and debt management division also calculates legally required transfers to the Debt Service Fund to accumulate funds for repayment of the general obligation bonds. In fiscal year 1998, these transfers totaled nearly $301 million.

- The cash and debt management division enters into lease purchase agreements for state agencies. The total payable at June 30, 1998, was approximately $28 million.

- The Department of Finance is responsible for transferring funds appropriated by the Legislature to the University of Minnesota. In fiscal year 1998 these transfers were about $593 million.

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- The Department of Finance, along with the Department of Public Service, administers the municipal energy loan program. Loans are made primarily to school districts. Loans outstanding at June 30, 1998, were nearly $15 million.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Conclusions

We qualified our report dated December 1, 1998, on the State of Minnesota's Comprehensive Annual Financial Report, because of uncertainties about the potentially adverse effect the year 2000 computer issue may have on state operations. Information technology experts believe that many computer applications in private businesses and government may fail as a result of data integrity problems and erroneous calculations beyond December 31, 1999. The state is currently addressing year 2000 issues related to its computer systems and other electronic equipment. In fiscal year 1996, the state established the Minnesota Year 2000 Project Office to develop and monitor the overall statewide effort for executive branch agencies. The project office is tracking over 1300 applications owned by state agencies that are critical to their operations. As of September 1998, the project office believed that 75 percent of the applications were compliant or had completed the necessary modifications. However, because of the unprecedented nature of the year 2000 issue, its effects and the success of related remediation efforts will not be fully determinable until the year 2000 and thereafter.

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 Department of Finance 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 Department of Finance does business will be year 2000 ready.

In accordance with *Government Auditing Standards*, we have also issued our report, dated December 1, 1998, on our consideration of the State of Minnesota's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. At a later date, we will issue our report on compliance with requirements applicable to the state's major federal programs and internal control over compliance in accordance with OMB *Circular A-133*.

For the areas audited, the Department of Finance's financial activities were fairly presented in the general purpose financial statements of the State of Minnesota's Comprehensive Annual Financial Report for the year ended June 30, 1998. For the areas tested, the department complied, in all material respects, with the federal requirements relating to cash management and indirect costs described in the OMB *Circular A-133 Compliance Supplement* for the year ended June 30, 1998. However, as a result of our procedures, we identified the following weaknesses in internal control at the Department of Finance:

1. **PRIOR FINDING NOT RESOLVED: The Department of Finance needs to improve its oversight of agencies preparing financial statement data.**

During the preparation of the fiscal year 1998 Comprehensive Annual Financial Report and the federal Single Audit expenditure schedules, we noticed several instances where the Department of Finance could have provided better direction and control over other state agencies it relied on for financial data. In some cases, agency personnel did not understand or did not apply the relevant accounting principles. In other instances, agencies did not have appropriate information to prepare the financial statements and schedules. Some agencies did not submit requested information timely.

The Department of Finance is ultimately responsible for the preparation of the state's Comprehensive Annual Financial Report and supplemental schedules. Minn. Stat. 16A.50 requires the department to submit a financial report, prepared in accordance with generally accepted government accounting principles, to the Legislature by December 31 of each year. To accomplish this, the department delegated some duties to other agencies and established a reporting timeline. The timeline allowed for review and revision of agency submitted data, formatting of the data for inclusion in the state's financial statements, and examination by the auditors to obtain an audit opinion. The Department of Finance correctly believed that the agencies were better able to prepare parts of the financial statements since they had more direct knowledge of the financial activity, or because the agency's subsystems maintained the transaction detail. Minn. Stat. Section 16A.06, Subd. 2, requires these agencies to provide financial information to the Department of Finance as requested.

The Department of Finance needs to improve their communication with agencies that provide financial information. When the Department of Finance relies on information from other agencies, it needs to provide those agencies with the information and guidance necessary to prepare the requested information. The Department of Finance needs to ensure that the agencies understand relevant accounting principals and how to apply them to their financial data. The Department of Finance needs to monitor the agencies' progress in meeting the reporting timelines, and help agencies to solve the problems that lead to late submission of information.

Some of the problems we noted that could have been alleviated by better oversight by the Department of Finance include:

- The Department of Public Safety did not understand grant accrual principles and submitted incorrect information.

- The Department of Employee Relations valued some of its investments at cost instead of at market value.

- The Minnesota State Retirement System did not provide accurate and complete data about its operations and disregarded reporting due dates.

- The Department of Finance was not aware that the Higher Education Services Office had an independent financial audit, and so did not use the audited amounts in its initial financial reports.

- The Department of Children, Families & Learning did not submit accurate federal expenditure schedules and missed the Department of Finance's reporting timelines.

Although we ultimately detected and corrected these and other errors through our audit work, the tardiness and inaccuracy of financial data submitted by other agencies unnecessarily compressed the time available for review and audit. This increased the risk that errors might not be detected and jeopardized the state's ability to meet its December 31 statutory reporting obligation. The errors could have been discovered earlier or avoided if the Department of Finance had worked more collaboratively with the agencies, combining their financial accounting knowledge with the agencies' program and transaction knowledge.

The Department of Finance also recognized the need to improve their process and has considered taking the following actions:

- Training –The Department of Finance plans to anticipate areas that may cause confusion and provide training to those agencies. Prior experience has shown that some agencies struggle with applying new accounting principles to state operations. Other agencies have difficulty consistently applying accounting principles from year to year. Changes in agency personnel, the implementation of a new program or accounting system, or changes in accounting principles can all lead to inaccurate, incomplete, inconsistent, or improper reporting of data by an agency.

- Monitoring –The Department of Finance intends to better monitor agencies' ability and willingness to meet the established reporting timelines. Finance may be able to improve the timeliness and accuracy of submitted data by identifying and resolving questions about the application of accounting principles, identifying appropriate and accurate data sources, involving higher level agency personnel, or providing additional employees.

Recommendation

- *The Department of Finance should provide better guidance, assistance, and oversight to state agencies to ensure that the agencies submit appropriate and timely financial statement information.*

2. The Department of Finance did not ensure that all of the invested treasurers cash (ITC) earnings were distributed to the participating funds.

The Department of Finance did not establish controls to ensure that all of the ITC earnings were allocated to the participating funds. Finance allocates ITC earnings to participating funds each month; however, it did not allocate approximately $2,665,000 during fiscal year 1998. The daily interest income for the last two days of July, August, and September 1997 was not included in the totals used to calculate the first quarter allocation for fiscal year 1998.

The Department of Finance also did not verify the total earnings for fiscal year 1997. The department did not reconcile earnings as reported by the State Board of Investment to MAPS, resulting in an underallocation of about $333,000.

In both instances, auditors detected the errors and notified the Department of Finance, which made the correction to the allocation amount. However, Finance should develop controls to ensure that it allocates all earnings to the participating funds.

Recommendation

- *The Department of Finance should reconcile State Board of Investment reports to MAPS to verify the accuracy of the ITC allocation.*

3. PRIOR FINDING PARTIALLY RESOLVED: The Department of Finance did not cancel outstanding warrants in accordance with statutory requirements.

The Department of Finance did not cancel warrants that were outstanding in excess of six months, as required by statute. Minn. Stat. Section 16A.45, Subd. 1 provides, in part:

> *Once each fiscal year the commissioner and the treasurer shall cancel upon their books all outstanding unpaid commissioner's warrants, except warrants issued for federal assistance programs, that have been issued and delivered for more than six months prior to that date and credit to the General Fund the respective amounts of the canceled warrants.*

As of June 30, 1998, warrants totaling $7.8 million had been outstanding for six months or more. Of that total, $4.9 million was outstanding for one year or more. Some of the warrants had been outstanding since 1991. The Department of Finance indicated that canceling warrants after only six months is not cost effective since a large number of warrants clear in the six month to one-year time frame.

The above statute conflicts with Minn. Stat. Chapter 345, Sections .31 through .60. That statute identifies unredeemed warrants as unclaimed property and requires the Department of Finance to follow a notification process and submit the unclaimed funds to the Department of Commerce. The department is currently seeking a statutory revision to resolve this conflict.

The Department of Finance obtained a listing of outstanding warrants as of June 30, 1998, issued from July 1, 1995, through June 30, 1997, from the State Treasurer. Finance, according to its records, deleted 4,249 outstanding warrants totaling $925,888; however, it did not include in its analysis the outstanding warrants issued by the tax subsystem, stating that it had delegated the responsibility for those outstanding warrants to the Department of Revenue. The Department of Finance has not followed up with the Department of Revenue to ensure that it is monitoring outstanding warrants as required by statute. As of June 30, 1998, there were tax subsystem warrants totaling over $3,000,000 that had been outstanding for more than six months.

Recommendations

- *The Department of Finance should continue to pursue a revision to Minn. Stat. Section 16A.45, Subd. 1.*

- *The Department of Finance should ensure that the Department of Revenue cancels its outstanding warrants, as required by statute.*

We prepared this report for the information of the Legislative Audit Commission and the management of the Department of Finance. 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 Deputy Legislative Auditor

End of Fieldwork: February 3, 1999

Report Signed On: March 8, 1999

Status of Prior Audit Issues
As of February 3, 1999

March 3, 1998, Legislative Audit Report 98-25 examined the department's activities and programs material to the State of Minnesota's Comprehensive Annual Financial Report and the Single Audit for the year ended June 30, 1997. The scope included general obligation bond sales, debt service transfers, master lease transactions, municipal energy loans, and appropriation transfers to the University of Minnesota. The audit also covered federal requirements relating to cash management and indirect costs. The report contained three findings. The department implemented one of the recommendations and is in the process of implementing the other two as discussed in this report.

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, any 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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Department of Finance

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March 4, 1999

James R. Nobles
Legislative Auditor
Office of the Legislative Auditor
1st Floor South – Centennial Building
658 Cedar Street
St. Paul, Minnesota 55155

Dear Mr. Nobles:

Thank you for the opportunity to discuss these findings with the staff in your office responsible for the Department of Finance audit. We are committed to providing accurate financial information to state agencies and the public. While improvements have been made in our processes the past few years, we also realize that other improvements are still needed.

Recommendation

The Department of Finance should provide better guidance, assistance, and oversight to state agencies to ensure that the agencies submit appropriate and timely financial statement information.

Response

We discussed our plan to provide better guidance and assistance to state agencies at a February meeting with staff from your office. We will continue to work with agencies on an individual basis that have historically had problems in financial reporting or single audit reporting. In addition, we plan to provide more individualized training to agency staff, supplementing the larger group sessions on changes in accounting principles and reporting requirements.

We will also better monitor reporting timelines and work with state agency staff and management to meet those timelines. We will continue to call agencies prior to the reporting deadlines to resolve any reporting issues or concerns and to make sure the financial statements will be completed on a timely basis. In addition, we will discuss any issues or problems in receiving timely financial statements with the appropriate individuals at the agencies.

When an agency's audited financial statements are not available for inclusion in the preliminary financial statements submitted to your office, we often include the preliminary, unaudited statements. The audited statements are included in the final statements. In the future, we will work with the state agencies to establish dates to receive the audited statements for inclusion in our preliminary financial statements.

Person responsible: Barb Ruckheim Estimated completion date: October 29, 1999

Recommendation

The Department of Finance should reconcile State Board of Investment reports to MAPS to verify the accuracy of the ITC allocation.

Response

Due to a change in our process the interest income for a few months was incorrectly allocated. This has been corrected and the process improved so that subsequent errors would not occur.

We have contacted the State Board of Investment and requested the reports necessary to reconcile the monthly ITC earnings to the amount reported in MAPS and subsequently allocated to the appropriate funds.

Person responsible: Ron Mavetz   Estimated completion date: June 30, 1999

Recommendations

The Department of Finance should continue to pursue a revision to Minn. Stat. Section 16A.45, Subd. 1.
The Department of Finance should ensure that the Department of Revenue cancels its outstanding warrants, as required by statute.

Response

The department is pursuing a revision to Minn. Stat. Section 16A.45, Subd. 1 to provide for canceling outstanding warrants after one year and to align this statute with Minn. Stat. Sections 345.31 – 60 which requires such abandoned property be sent to the Department of Commerce Unclaimed Property Division.

The department has established a procedure for canceling outstanding 3 and 4 series warrants and will work with the Department of Revenue to establish consistent policies and procedures for canceling outstanding tax subsystem warrants (2 series) to ensure compliance with statutory requirements.

Person responsible: Paul Conery   Estimated completion date: October 31, 1999

Sincerely,

Pamela Wheelock

Pamela Wheelock
Commissioner