
Office of the Attorney General

Financial and Compliance Audit For the Two Years Ended December 31, 1998

September 1999

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Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

99-49

SUMMARY

State of Minnesota

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Office of the Attorney General

Financial and Compliance Audit For the Two Years Ended December 31, 1998

Public Release Date: September 10, 1999

No. 99-49

Background Information

The Office of the Attorney General was established by Article V of the constitution of the State of Minnesota. During the audit period, Hubert H. Humphrey III was the Attorney General. Mike Hatch is the current Attorney General. The Attorney General's main duties include providing legal advice, representing state agencies and their officials, and offering direct assistance to citizens of Minnesota. The Attorney General also represents Minnesota in civil and criminal cases and is a member of the Executive Council, the Pardons Board, the Land Exchange Board, and the State Board of Investment.

Objectives and Conclusions

The objectives of our audit were to gain an understanding of the internal control structure over the accounting and reporting of financial activities of the agency and to determine if the Office of the Attorney General complied with material finance-related legal provisions. The areas covered by our audit were partner agency agreements, fines and restitutions, tobacco settlement receipts, payroll, rent, claims, professional/technical services, and supply and equipment purchases for the period January 1, 1997, through December 31, 1998.

The Attorney General's Office (AGO) properly collected, deposited, and recorded revenues for attorney general services, fines, and restitutions on the state's accounting system. The AGO also adequately supported and accurately recorded its payroll and other expenditures in the state's accounting records. In addition, for the items tested, the AGO complied with material finance-related legal provisions and bargaining unit agreements. However, the AGO did not bill for the full cost of services for non-general funded activities.

The Attorney General responded that his office will continue to work with the Department of Finance to determine appropriate funding for the AGO, including the issue of billing for the full cost of services for non-general funded activities.



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 Mike Hatch
Attorney General

We have audited the Office of the Attorney General for the period January 1, 1997, through December 31, 1998, as further explained in Chapter 1. Our audit scope included revenues from partner agreements, fines and restitutions, payroll, rent, claims, professional/technical services, supplies, and equipment.

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 also require that we design the audit to provide reasonable assurance that the Office of the Attorney General complied with provisions of laws, regulations, and contracts significant to the audit. The management of the Office of the Attorney General is responsible for establishing and maintaining the internal control structure and for compliance with applicable laws, regulations, and contracts.

This report is intended for the information of the Legislative Audit Commission and the management of the Office of the Attorney General. This restriction is not intended to limit the distribution of this report, which was issued as a public document on September 10, 1999.

James R. Nobles
Legislative Auditor

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: April 2, 1999

Report Signed On: September 3, 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
Thomas Donahue, CPA,	Audit Manager
Tony Toscano	Auditor-in-Charge
Susan Kachelmeyer, CPA	Senior Auditor
Brian Swartz	Auditor

Exit Conference

We discussed the results of the audit with the following staff of the Office of the Attorney General at an exit conference held on August 31, 1999:

Mike Hatch	Attorney General
Rebecca Spartz	Director of Administration
Terence Pohlkamp	Fiscal Services Director
Sandra Caron	Human Resources Director
Patricia Gallatin	Docketing Supervisor

Office of the Attorney General

Chapter 1. Introduction

The Office of the Attorney General (AGO) was established by Article V of the constitution of the State of Minnesota. Among the activities the AGO lists in its mission statement are:

- to protect the interests of the citizens of Minnesota by enforcing the laws enacted by the Legislature,
- to defend the state in all legal proceedings, and
- to ensure the legality of government action.

The Attorney General also represents Minnesota in civil and criminal cases and is a member of the Executive Council, the Pardons Board, the Land Exchange Board, and the State Board of Investment. Hubert H. Humphrey III was the Attorney General during the time period covered by this audit. Mike Hatch was elected Minnesota's Attorney General in November 1998 and took office on January 4, 1999.

Table 1-1 provides a summary of the AGO's expenditure activity for fiscal year 1998.

Table 1-1			
Summary of Expenditures by Fund			
Fiscal Year 1998			
	<u>General Fund</u>	<u>Special Revenue Fund</u>	<u>Other Funds</u>
Expenditures:			
Payroll	\$26,845,932	\$1,283,267	\$174,814
Rent	2,660,144	54,003	2,716
Claims	132,029	34,123	938,026
Supplies	771,595	36,766	12,214
Equipment	573,016	20,809	590
Professional/Technical Services	456,100	56,894	27,988
Other	<u>1,312,730</u>	<u>272,963</u>	<u>88,463</u>
Total	<u>\$32,751,546</u>	<u>\$1,758,825</u>	<u>\$1,244,812</u>

Source: Financial information obtained from the state's accounting system.

On May 8, 1998, the Attorney General's Office, on behalf of the State of Minnesota, reached an out-of-court settlement with the tobacco industry. As a result of that court-approved settlement, the State of Minnesota was awarded approximately \$6.4 billion to be distributed over 25 years. Also, in accordance with the settlement, the court approved the establishment of the Minnesota Partnership for Action Against Tobacco (MPAAT), a nonprofit organization created to administer two antismoking program accounts: the national research account and the smoking cessation account. In addition, the settlement directed the tobacco industry to fund the accounts

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\$100 million and \$102 million, respectively. The AGO provided temporary administrative support to MPAAT during the latter six months of the audit period.

On behalf of MPAAT, the AGO received \$10 million for the national research account in June 1998. These funds represented the first of ten annual payments of \$10 million each June 1st through June 1, 2007. The AGO transferred these funds, plus interest, to MPAAT by the end of 1998. In the future, payments to the national research account will go directly to MPAAT. The smoking cessation account was funded by a one-time lump sum payment of \$102 million. The tobacco industry paid the lump sum directly to MPAAT in December 1998.

In September 1998, the AGO received \$240 million in tobacco settlement funds and deposited them to the state's General Fund. The Attorney General's Office does not have access to tobacco settlement funds for its own use.

Chapter 2. Funding Sources and Other Revenues

Chapter Conclusions

The Attorney General's Office (AGO) properly collected, deposited, and recorded revenues for AGO services, fines, and restitutions on the state's accounting system. In addition, except for the following issue, for the items tested, the AGO complied with material finance-related legal provisions. The AGO did not bill for the full cost of services for non-general funded activities.

Funding of AGO services has been and continues to be an evolving process. The process has included input from many agencies with differing viewpoints and perspectives: the Legislature, the Attorney General's Office, the Department of Finance, state departments and agencies, and other constituencies served by the AGO. During the audit period, the 1998 Legislature directed the commissioner of Finance and the AGO to convene a joint task force to evaluate: the availability of legal services; the adequacy and suitability of the current mechanism for funding legal services; the appropriateness of billing rates; and the appropriateness of the current process for setting billing rates.

Currently, AGO services are funded through direct appropriations from the Legislature and agreements with various state departments and agencies. Under Minn. Stat. Section 8.15, Subdivision 3, the AGO has the authority to enter into agreements with state departments and agencies for legal services. During fiscal year 1998, the AGO received a General Fund appropriation of \$25.3 million and collected approximately \$8.5 million through agreements with state agencies to fund its operations.

Funding for AGO services begins with the budgetary process. The budget of the AGO represents the operating costs of the AGO, including the cost of legal services provided to state agencies, quasi-state agencies and political subdivisions that are not otherwise provided for within the budget of a state agency. The cost for legal services to a state agency that has an agreement with the AGO is generally provided for within that agency's budget.

A state agency under contract with the AGO may be classified as either a full-partner or semi-partner agency. Generally, a full-partner agency bears the cost of AGO services through its operating budget. The full-partner agreement reflects the estimated annual cost of providing legal services. The AGO and the agency work together to determine what legal services are needed and the appropriate number of attorney and legal assistant hours to be charged. Semi-partner agencies are those agencies that receive services from the AGO through the AGO's appropriation but need additional services and enter into agreements to fund those services. State agencies that do not have an agreement for legal services are referred to as "pooled agencies." Legal services provided to pooled agencies are funded through the AGO's appropriation.

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During fiscal year 1998, the AGO had agreements in place with eight partner agencies and eight semi-partner agencies. As shown in Table 2-1, the AGO received approximately \$8.48 million from partner agencies under the full and semi-partner agreements during fiscal year 1998. Legal services actually provided under those agreements was approximately \$8.43 million.

Approximately once a quarter, a partner agency pays the AGO for a portion of the agreed upon legal services. The terms of the individual agreements determine when and how an agency pays the AGO. During the audit period, partner agencies either paid by state payment vouchers or appropriation transfers. In accordance with Minn. Stat. Section 8.15, Subd. 3, funds received under the agreements were collected and deposited to the General Fund and were appropriated to the AGO.

Table 2-1
Full and Semi-Partner Agreements
Fiscal Year 1998

<u>Agency</u>	<u>Partner Status</u>	<u>Services Provided Under Agreement</u>	<u>Partner Payments per Agreement</u>
Risk Management.	Full	\$ 33,343	\$ 32,343
Agricultural Utilization Research Institute	Full	7,031	14,280
Department of Children, Families, & Learning	Semi	634,182	543,750
Department of Corrections	Semi	228,048	105,000
Department of Finance	Full	589,789	597,680
Department of Health	Semi	755,280	711,845
Housing Finance Agency	Semi	105,247	78,132
Department of Human Services	Semi	1,519,607	1,567,780
Medical Practices Board	Full	1,445,065	1,416,000
MnSCU	Full	1,101,749	1,157,250
Department of Natural Resources	Full	848,200	1,036,698
Department of Administration, Office of Technology	Full	19,797	84,000
Petroleum Tank Release Compensation Board.	Full	120,092	105,000
Pollution Control Agency	Semi	708,391	733,244
Department of Public Safety	Semi	115,899	105,000
Department of Transportation	Semi	194,348	198,220
Total		<u>\$8,426,068</u>	<u>\$8,486,222</u>

Source: Auditor prepared from AGO billing system and partner agency agreements.

As a general rule, the AGO does not “settle up” at fiscal year end with partner agencies that either paid too much or too little for services. The agreements reflect a degree of uncertainty at the time they are established as to the extent of future legal services required. However, in certain circumstances, the AGO has adjusted partner agreement amounts to more closely represent the actual level of services provided. Overall, as shown in Table 2-1, for fiscal year 1998, the amount collected for legal services exceeded the cost for legal services provided by approximately \$57,000 or less than one-half of one percent.

The AGO maintained a billing and accounts receivable system during the audit period to track attorney and legal assistant charges. Approximately once a month, the AGO sent out invoices and information reports to semi-partner and pooled agencies for non-general funded activities.

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During fiscal year 1998, semi-partner and pooled agencies reimbursed the General Fund approximately \$5.4 million. These funds were deposited to the General Fund as non-dedicated revenue in accordance with Minn. Stat. Section 8.15, Subd. 5. Full-partner agencies pay according to their agreements. All agencies receiving AGO services, including full-partner agencies, receive the information reports. The agencies use the reports to monitor the legal services provided.

During the audit period, the following hourly rates were charged for AGO services under the partner agreements, as shown in Table 2-2:

Table 2-2 AGO Billing Rates Fiscal Year			
	<u>1997</u>	<u>1998</u>	<u>1999</u>
Attorneys	\$62	\$70	\$79
Legal Assistants	\$46	\$55	\$60

Source: These rates were determined in consultation with the commissioner of Finance as required by Minn. Stat. Section 8.15, Subd. 1.

The AGO monitors semi-partner and pooled agencies to ensure that the General Fund is reimbursed appropriately. However, we noted that for one agency, the prior year account receivable balance as of December 31, 1998, was approximately \$1.1 million. According to the AGO, the Department of Public Safety (DPS) owed the General Fund approximately \$900,000 and \$200,000 for legal services provided in fiscal years 1998 and 1997, respectively. The amounts were payable from the Trunk Highway Fund. The AGO indicated that the department was seeking additional appropriations in its 2000/2001 biennial budget to reimburse the General Fund. The 1999 Legislature did not approve DPS's appropriation request for Trunk Highway Fund monies to either reimburse the General Fund for past AGO services or future AGO service costs.

Additionally, the AGO collected fines and restitutions as a result of cases prosecuted during the audit period. Total fines and restitutions collected during the audit period were approximately \$3.5 million of which approximately \$2.1 million was deposited to the General Fund as a nondedicated receipt.

Audit Objectives and Methodology

Our review of AGO funding sources and revenues focused on the following questions:

- Did the AGO design and implement internal controls to provide reasonable assurance that revenues for AGO services, fines, and restitutions were properly collected, deposited, and accounted for in the state's accounting system?
- Did the AGO comply with material finance-related legal provisions?

To answer these questions, we interviewed agency employees to gain an understanding of the internal controls over revenues generated under partner agreements, billings to non-partner

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agencies, fines, and restitutions. We reviewed partner agency agreements and state accounting records to determine if the AGO received all the revenues it was entitled to receive under the agreements. We reviewed the AGO's determination of its attorney and legal assistant billing rates to determine if the process was systematic and reasonable. We also reviewed AGO records to determine that it properly accounted for all fines and restitutions.

Conclusions

The Attorney General's Office properly collected, deposited, and recorded revenues for AGO services, fines, and restitutions on the state's accounting system. In addition, except for the following issue, for the items tested, the AGO complied with material finance-related legal provisions. As explained in Finding 1, the AGO did not bill for the full cost of services for non-general funded activities.

1. The AGO did not bill its full cost for legal services provided to state agencies for non-general funded activities.

Currently, the AGO uses a calculated hourly billing rate for attorney and legal assistants as the mechanism to recover the full cost of legal services provided. For fiscal year 1998, the AGO calculated a billing rate of \$76.50 per hour for attorneys and \$58 per hour for legal assistants to recover full cost. However, there was a difference of opinion between the AGO and the Department of Finance in interpreting the meaning of "full cost of services" pursuant to Minn. Stat. Section 8.15, Subd. 5, and determining which costs should be included in the billing rate. The AGO adjusted its fiscal year 1998 billing rates for attorneys and legal assistants to \$70 per hour and \$55 per hour, respectively. For fiscal year 1999, the AGO, in consultation with the Department of Finance, "agreed" to a billing rate that was calculated without the inclusion of rent as a cost factor.

Minn. Stat. Section 8.15, Subd. 1, provides that the AGO, in consultation with the commissioner of Finance shall develop a fee schedule to be used by the AGO in developing the (partner) agreements. Minn. Stat. Section 8.15, Subd. 5, provides that:

State agencies receiving legal services from the attorney general for nongeneral funded activities shall reimburse the full cost of those services to the general fund based on periodic billings prepared by the attorney general. Payment must be made to the attorney general for deposit to the general fund as a nondedicated receipt. The attorney general, in consultation with the commissioner of finance, shall develop reimbursement policies and procedures related to legal services.

As a practical matter, the AGO has developed a single billing rate for attorneys and legal assistants to serve as the rate used in the partner agreements and to bill other agencies the "full cost" of legal services provided for non-general funded activities. The billing rates used in the partner agreements are negotiated in consultation with the commissioner of Finance. The AGO and the Department of Finance believe that the billing rates used in the partner/semi-partner agreements under Minn. Stat. Section 8.15, Subd. 3, are not required to recover full cost. The rates used exclude rent, which is considered to be a fixed cost.

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However, Minn. Stat. Section 8.15, Subd. 5, directs the AGO to bill the full cost of services provided to agencies for non-general funded activities. This is not a funding mechanism for the AGO. Amounts collected are deposited to the General Fund as nondedicated receipts. In this capacity, the AGO is acting on behalf of the General Fund, which financed the legal services provided to non-general funded activities. Accordingly, for the AGO to be in compliance with Minn. Stat. Section 8.15, Subd. 5, we believe that it must bill state agencies for the full cost of providing legal services, including rent, for non-general funded activities. The concept of full cost includes both direct and indirect costs associated with providing legal services.

Recommendation

- *The AGO should bill the full cost of providing legal services to state agencies for non-general funded activities.*

Chapter 3. Payroll and Other Expenditures

Chapter Conclusions

The Attorney General's Office adequately supported and accurately recorded its payroll and other administrative expenditures in the state's accounting records. In addition, for the items tested, the AGO complied with material finance-related legal provisions and bargaining unit agreements.

The Attorney General's Office expended approximately \$35.8 million during fiscal year 1998. The largest expenditure for the AGO was payroll, which accounted for approximately 79 percent of total expenditures. Other expenditures included in the audit were rent, claims, supplies, professional/technical services, and equipment. The AGO spent approximately \$2.7 million on rent, \$1.1 million on claims, \$821,000 on supplies, \$594,000 on equipment, and \$541,000 on professional/technical services in fiscal year 1998.

Audit Objectives and Methodology

Our review of AGO payroll and other expenditures focused on the following questions:

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

To answer these questions, we interviewed AGO employees to gain an understanding of the controls over the payroll and personnel process and the procurement and disbursement process for leases, services, supplies, and equipment. We tested a sample of the AGO's expenditure transactions and supporting documentation to determine if they were properly authorized, adequately supported, and accurately recorded.

Conclusions

The Attorney General's Office adequately supported and accurately recorded its payroll and other expenditures in the state's accounting records. In addition, for the items tested, the AGO complied with material finance-related legal provisions and bargaining unit agreements.

Status of Prior Audit Issues As of April 2, 1999

Most Recent Audit

Legislative Audit Report 97-48, issued in September 1997, covered AGO funding sources and revenues, fines and restitutions, federal grants, payroll, and other administrative expenditures for the period January 1, 1995, through December 31, 1996. The report contained seven findings.

The Office of the Attorney General implemented six of the seven recommendations discussed in the report. The AGO has made strides in establishing a process to determine an appropriate billing rate that ensures the full recovery of legal service costs. However, full compliance has not yet been accomplished. See our current Finding 1 in Chapter 2.

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.



STATE OF MINNESOTA
OFFICE OF THE ATTORNEY GENERAL

MIKE HATCH
ATTORNEY GENERAL

September 1, 1999

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Mr. James R. Nobles
Legislative Auditor
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658 Cedar Street
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Re: ATTORNEY GENERAL AUDIT

Dear Mr. Nobles:

Thank you for the opportunity to respond to the recommendation provided in your recent financial audit of the Attorney General's Office. This audit covered activities in the AGO during the two-year period ending December 31, 1998.

Enclosed is my Office's response to the recommendation your auditors made about billing rates.

It has been a pleasure for our staff to work with your audit team. If we can be of further assistance, please contact me.

Very truly yours,

MIKE HATCH
Attorney General

(651)297-4272

OFFICE OF THE ATTORNEY GENERAL

RESPONSE TO AUDIT FINDING

Chapter 2. Funding Sources and Other Revenues

AGO Billing Rates - Finding

1. The AGO did not bill its full cost for legal services provided to state agencies for non-general funded activities.

Recommendation

The AGO should bill the full cost of providing legal services to state agencies for non-general funded activities.

Response

This issue has been discussed by the AGO and the Department of Finance, most recently during the AGO Funding Task Force and the development of billing rates for FY 2000-2001. During the last legislative session the legislature passed a rider to the AGO budget requiring the AGO and DOF to continue working together to determine appropriate funding for the AGO. We anticipate discussing this issue in meetings with DOF.