



**OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA**

FINANCIAL AUDIT DIVISION REPORT

State Government Shutdown

Internal Controls and Compliance Audit

Fiscal Years 2011 and 2012

June 14, 2012

Report 12-12

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OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

June 14, 2012

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Legislative Audit Commission

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Department of Management and Budget

Brenda Cassellius, Commissioner
Department of Education

Mark Phillips, Commissioner
Department of Employment and Economic Development

Lucinda Jesson, Commissioner
Department of Human Services

Myron Frans, Commissioner
Department of Revenue

This report presents the results of our internal controls and compliance audit of the State Government Shutdown for the period leading up to, during, and after the state shutdown.

We discussed the results of the audit with the departments of Management and Budget, Education, Employment and Economic Development, Human Services, and Revenue staff during May 2012. This audit was conducted by Cecile Ferkul, CPA, CISA, (Deputy Legislative Auditor) and Tim Rekow, CPA (Auditor-in-Charge), assisted by auditors Joseph McMahon, CPA, and Tom Foeller.

This report is intended for the information and use of the Legislative Audit Commission and the management of the departments of Management and Budget, Education, Employment and Economic Development, Human Services, and Revenue. This restriction is not intended to limit the distribution of this report, which was released as a public document on June 14, 2012.

We received the full cooperation of staff while performing this audit.

A handwritten signature in black ink that reads "James R. Nobles".

James R. Nobles
Legislative Auditor

A handwritten signature in black ink that reads "Cecile M. Ferkul".

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

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Report Summary

Conclusion

The State of Minnesota generally had adequate internal controls to ensure that it effectively prepared for, managed, and reviewed financial activities during the July 2011 state government shutdown and complied with finance-related legal provisions.¹ However, certain state agencies had weaknesses in the areas of shutdown planning and oversight.

Findings

- The Department of Management and Budget did not ensure that it provided the Ramsey County District Court with accurate and complete lists of agencies' priority critical services for the shutdown period. ([Finding 1, page 7](#))
- Certain state agencies may not have adequately followed procedures related to the oversight and review of shutdown activities. ([Finding 2, page 8](#))
- Certain state agencies inaccurately compensated a few employees during the shutdown. ([Finding 3, page 9](#))

Audit Objectives and Scope

Objectives

- Internal Controls
- Legal Compliance

Period Audited

Fiscal years 2011 and 2012; specifically, the time period leading up to, during, and after the July 2011 state shutdown

Programs Audited

- Planning and Oversight
- Expenditures
- IT Security

- Payroll and Personnel Expenses
- Revenues

¹ State Agencies specifically reviewed included the departments of Education, Employment and Economic Development, Human Services, Management and Budget, and Revenue.

State Government Shutdown

Overview

From July 1 through July 20, 2011, much of the State of Minnesota's government operations shut down. The shutdown occurred because the 2011 Legislative Session ended without reaching an agreement on budget appropriations to fund operations of state government. Without appropriations, most state agencies had no authority to continue operations beyond June 30, 2011. The budget impasse ended on July 19, 2011, after Governor Dayton announced he would accept the last Republican offer before the shutdown, with certain conditions. On July 20, 2011, the Legislature passed the budget bills, which were signed the same day by the Governor and allowed noncritical state government services to resume and employees to return to work.

Going into the 2011 Legislative Session, state government faced a budget shortfall totaling approximately \$5 billion for the state fiscal year 2012 through 2013 biennium.² Governor Mark Dayton vetoed nine of the ten budget bills passed by the Legislature; only the Omnibus Agriculture Appropriations Bill was passed and signed into law on April 15, 2011.³ The Governor did not call a special session to address the budget issues.

The state constitution prohibits any payment out of the state treasury except as allowed by legislative appropriation.⁴ However, during prior disruptions to government operations, state courts had determined that priority critical services must continue.⁵ The court identified "priority critical services" as those activities necessary to prevent a potential immediate threat to public health or safety.

On June 15, 2011, Governor Dayton's administration submitted to the Ramsey County Court a list of priority critical services that it recommended for continuation during a possible shutdown. The court heard the Governor's petition on June 23, 2011. The court ordered temporary funding of priority critical services.⁶ On July 1, 2011, the Governor shut down all state government operations not identified in the court order as priority critical services and laid-off employees not supporting the priority critical services. The court appointed a retired Minnesota Supreme Court Justice, Kathleen Blatz, as the Special Master who would determine whether additional state functions were priority critical services that would resume operation during the shutdown. During the shutdown,

² The state fiscal year is July 1 through June 30.

³ Minnesota Laws 2011, chapter 14, section 3.

⁴ *Minnesota Constitution*, article XI, section 1.

⁵ In 2001 and 2005, the Minnesota Attorney General petitioned Ramsey County Court to preserve the operation of core functions of the executive branch of government after a budget was not enacted to fund state government. In each case, the court ordered the continued performance of priority critical services (Orders C9-01-5725 and C0-05-5928).

⁶ Ramsey County Court File No. 62-CV-11-5203.

as the Special Master authorized additional state functions as priority critical services, state agencies worked with the Department of Management and Budget to recall employees to support the identified priority critical services.

The Department of Management and Budget entered into a Memorandum of Understanding with the state employees' unions to define the labor policies and procedures for laid-off employees during the shutdown. The department also created and communicated various payroll, benefit, budget, and other pertinent shutdown information to agencies via e-mail and Web site postings.

The state used its previously developed National Incident Management System as the framework and structure to manage the state government shutdown.⁷ Specifically, the Department of Management and Budget's statewide contingency response team provided statewide incident management direction to state agency operation centers to ensure priority critical services continued as directed by the courts.⁸ The department also developed a state shutdown communication plan, which included planning and operational guides. Prior to and during the shutdown, the Department of Management and Budget used a dedicated Web site to communicate policies and procedures to critical employees at state agencies.⁹ The department required state agencies to name a shutdown planning coordinator, create a shutdown planning team, document the entity's priority critical services and the minimum staffing needed for those services, and create a shutdown plan, along with additional requirements.

Table 1 provides the Department of Management and Budget's recap of actual spending during the shut down period from July 1 through July 20, 2011. The department stated that the amount spent was approximately 70 percent of the \$2.6 billion spent a year earlier for the same 20-day period.

⁷ The Federal Emergency Management Agency National Incident Management System provides a systematic, proactive approach to guide departments and agencies, at all levels of government, to prevent, protect against, respond to, recover from, and mitigate the effects of incidents in order to reduce the loss of life and property and harm to the environment.

⁸ The Statewide Contingency Response Team was comprised of six Department of Management and Budget employees and met twice daily, as well as on an "as needed" basis during the state shutdown.

⁹ www.bereadymn.com.

Table 1
State Shutdown Spending¹
July 1, 2011, through July 20, 2011
All Funding Sources²
(in thousands)

	<u>Payroll Costs</u>	<u>Other Expenses</u>	<u>Total</u>
General Fund	\$ 40,338	\$ 929,768	\$ 970,106
Other State Funds	59,532	167,694	227,226
Federal Funds	3,017	593,569	596,586
Total	<u>\$102,887</u>	<u>\$1,691,031</u>	<u>\$1,793,918</u>

¹State Shutdown Spending included the costs of the Minnesota State Colleges and Universities System (MnSCU), which continued operating without state General Fund appropriations on the basis of tuition and existing cash balances. The table does not include the costs of the University of Minnesota, which is constitutionally separate and operates outside of the state treasury.

²All funding sources included direct appropriations, statutorily dedicated state funds that did not require legislative action, and federal funds that flowed through the state treasury.

Source: The Department of Management and Budget's *State Government Shutdown Executive Summary*, published in October 2011. The report recaps and analyzes the financial activity that occurred during the shutdown and is available at the following Web site: <http://tinyurl.com/bm28czt>.

Objectives, Scope, and Methodology

Our audit of state agencies' shutdown planning and oversight; payroll, personnel, and other transactions; revenues; and information technology security focused on the following audit objectives for the period leading up to, during, and after the state shut down:

- Were the state agencies' internal controls adequate to ensure they effectively prepared for, managed, and reviewed state shutdown financial activities?
- Did the entity comply with significant finance-related legal requirements?

To meet the audit objectives, we gained an understanding of the state agencies' financial policies and procedures. We considered the risk of errors in the accounting records and potential noncompliance with relevant legal requirements. We analyzed accounting data for all financial activity occurring during the state shutdown to identify unusual trends or significant changes in financial operations; we followed up on those items identified by the analysis. We examined internal controls and compliance for a sample of financial transactions of the departments of Education, Employment and Economic Development, Human Services, Management and Budget, and Revenue. Table 2 recaps these departments' expenditure and revenue transactions during the shutdown period.

Table 2
Payroll Costs, Other Expenses, and Receipts
During the Shutdown for Departments Tested¹
July 1, 2011, through July 20, 2011
(in thousands)

Agency	Payroll Costs ²	Other Expenses ³	Receipts
Human Services	\$11,939	\$1,091,294	\$ 471,368
Employment and Economic Development	2,934	67	1,015
Management and Budget	811	22,085	81,529
Revenue	191	37,687	575,769
Education	53	360,321	0
Total	<u>\$15,928</u>	<u>\$1,511,454</u>	<u>\$1,129,681</u>

¹The totals in the above table differ from the totals the Department of Management and Budget included in its *State Government Shutdown Executive Summary* report due to timing differences and differences in estimated calculations.

²We calculated payroll costs by adding the estimated parts of the pay periods that overlapped the beginning and end of the shutdown period (three days of pay period ended July 4, 2011, and one day of pay period ended July 29, 2011) to the actual payroll for the pay period ended July 19, 2011.

³Other expenses included grants, aids, and various administrative expenses authorized as priority critical services by the Ramsey County District Court.

Source: The state's accounting system - Statewide Integrated Financial Tools (SWIFT).

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives.

We used various criteria to evaluate internal controls and compliance. We used, as our criteria to evaluate agency controls, the guidance contained in the *Internal Control-Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission.¹⁰ We used state and federal laws, regulations, and contracts, as well as policies and procedures established by the departments of Management and Budget and Administration and the state agencies' internal policies and procedures as evaluation criteria over compliance.

Conclusion

The state's internal controls were generally adequate to ensure that it effectively prepared for, managed, and reviewed financial activities during the July 2011 state government shutdown and complied with significant finance-related legal requirements. However, there were weaknesses in the areas of shutdown planning and oversight and inaccurate compensation at certain state agencies.

The following *Findings and Recommendations* provide further explanation about the exceptions noted above.

¹⁰ The Treadway Commission and its Committee of Sponsoring Organizations were established in 1985 by the major national associations of accountants. One of their primary tasks was to identify the components of internal control that organizations should have in place to prevent inappropriate financial activity. The resulting *Internal Control-Integrated Framework* is the accepted accounting and auditing standard for internal control design and assessment.

Findings and Recommendations

The Department of Management and Budget did not ensure that it provided the Ramsey County District Court with accurate and complete lists of agencies' priority critical services for the shutdown period.

Finding 1

The Department of Management and Budget did not receive some information it requested about agencies' determinations of priority critical services and staffing needed to maintain those services. The departments of Education and Revenue submitted their required priority critical service and minimum staffing information to the Department of Management and Budget; however, they did not provide complete information. The departments of Education and Revenue had gaps in reporting their noncritical staffing numbers and closed services.¹¹ Without a complete list of noncritical staffing numbers and closed services, the Department of Management and Budget could not assure that priority critical services and staffing needed to maintain those services was complete and reasonable for approval.

In addition, the Department of Management and Budget reported some priority critical service minimum staffing levels to the Ramsey County Court that were different than the amounts determined by the agencies. The department reported the Department of Human Services' required minimum staffing as 5,165 instead of 3,285, and the Department of Revenue's required minimum staffing as 43 instead of 57.

The Department of Management and Budget designated the State Priority Service Review Committee to review and approve the state agency priority critical services and minimum staffing lists. This review and approval process should have ensured that the priority critical services and minimum staffing list information was complete and accurate for submission to the Ramsey County Court on behalf of the Governor's office.

Recommendation

- *The Department of Management and Budget should review current planning documents to ensure they provide agencies with clear instructions for data preparation.*

¹¹ Department of Management and Budget communicated priority critical service and minimum staffing list completion criteria to state agencies in Appendix C of the State Agency Government Contingency Planning Guide.

Finding 2

Certain state agencies may not have adequately followed procedures related to the oversight and review of shutdown activities.

Staff of the Department of Management and Budget and Department of Revenue stated they identified shutdown risks and control activities as part of identifying critical priority services; however, they did not document these risks or the key control activities identified to mitigate these risks. After the shutdown, the Department of Management and Budget did not document its review of significant transactions processed during the shutdown to ensure the propriety of those transactions. The Department of Revenue's staff told us their normal, internal control activities, which they maintained during the shutdown, were sufficient to ensure transactions were authorized and appropriate.

In addition, the Department of Education established and documented a risk assessment, key control activities, and created a plan to review shutdown activities. However, as of February 2012, nearly seven months after the state shutdown ended, department staff had not completed the shutdown review.

In a June 7, 2011, memo to agency heads, Commissioner Schowalter of the Department of Management and Budget communicated his expectations that they would maintain strong internal controls during the shutdown.¹² The memo stated:

Established control activities may need to be suspended in the event of the state government shutdown. Because of this, it is important for you and your staff to identify now what could go wrong within your priority services during a time of disruption and the key control activities you have in place to mitigate those risks.

The commissioner's memo also stated:

For those critical financial activities where sufficient separation of duties, reviews and approvals, or reconciliations cannot continue, agencies will need to put steps into place to retroactively review and approve transactions, as well as resume key reconciliations, once the shutdown is over. In other words, you must establish an internal process to review the financial transactions that occurred during the shutdown, to ensure the propriety and accuracy of those agency transactions.

In July 2011, after the shutdown, the Department of Management and Budget also communicated to state agencies, in an *Internal Controls Bulletin*, that they were responsible to determine the need to maintain internal controls during shutdown

¹² The Department of Management and Budget communicated risk assessment, internal control, and review expectations for the shutdown to all state agency heads on June 7, 2011.

recovery and to review significant transactions processed during the shutdown for propriety and adequate documentation.¹³

Without adequate internal controls, including a retroactive review of financial transactions, the risk of improper (unauthorized or inaccurate) transactions increased.

Recommendation

- *The departments of Management and Budget, Revenue, and Education should document the procedures they used to identify risks, key control activities, and reviews of significant transactions processed during the shutdown and take any remaining actions necessary to ensure the propriety of the transactions.*

Certain state agencies inaccurately compensated a few employees during the shutdown.

Finding 3

The departments of Human Services and Employment and Economic Development did not have internal controls over certain shutdown payroll transactions and did not detect unauthorized employee compensation. Although the departments of Human Services and Employment and Economic Development reviewed payroll transactions, their reviews did not detect the following errors:

- The Department of Human Services incorrectly paid three ineligible noncritical employees \$9,378 during the shutdown. For these employees, Department of Human Services' human resources staff neglected to enter leave for salary savings, as required in the Memorandum of Understanding between the Department of Management and Budget and the unionized state employees. Recording payroll as leave for salary savings would have ensured that the noncritical exempt employees would not be paid. Although the Department of Human Services reconciled its paid employees to the list of employees identified as providing priority critical services, the review did not detect these errors.
- The Department of Employment and Economic Development incorrectly paid an ineligible, noncritical employee \$1,647 during the shutdown. This employee received Family Medical Leave Act sick pay during the shutdown; however, the Department of Management and Budget's policy

¹³ The Department of Management and Budget Internal Controls Bulletin, Volume 3, Issue 7, July 28, 2011.

prohibited these payments for state employees who were identified as noncritical.¹⁴

Recommendations

- *The departments of Human Services and Employment and Economic Development should recover the unauthorized compensation.*
- *The Department of Management and Budget should work with state agencies to ensure that the state recovers any other unauthorized compensation that occurred during the shutdown.*

¹⁴ On May 26, 2011, the Department of Management and Budget stated on the Web site providing shutdown information to agency management (www.bereadymn.com) that laid-off, noncritical employees would not be able to use Family Medical Leave Act leave during the shutdown.



June 8, 2012

James R. Nobles, Legislative Auditor
Office of the Legislative Auditor
140 Centennial Building
658 Cedar Street
St. Paul, MN 55155

Dear Mr. Nobles:

Thank you for the opportunity to review and respond to the findings and recommendations included in the OLA report pertaining to the state's internal controls and compliance for the July 2011 state government shutdown.

As you know, the state has never experienced a disruption of government services of this size and scope. We hope that it never has to again. The financial, employee relations and legal challenges facing the state were unprecedented and potential for unanticipated problems was great. MMB outlined the costs and challenges in a report released in November of 2011 and we appreciate the OLA's use of some of that material in your report.

Given the extreme challenges, we are pleased you found that "the state's internal controls were generally adequate to ensure that it effectively prepared for, managed, and reviewed state shutdown financial activities and complied with significant finance-related legal requirements." This is testament to the dedication, knowledge and hard work of thousands of state employees who completed this work under tremendously difficult circumstances. State employees demonstrated professionalism and resolve in protecting public resources even at a time when their future services were in question.

In response to your findings, MMB has reviewed and will provide updated directions for the Agency Planning Guidance documents as it relates to completion of the Agency priority services. If such an event occurs again, we will better document our review processes and procedures for significant transactions. Finally, we will continue to work with other agencies to recover any unauthorized compensation or payments that may have been made.

Again, thank you for allowing us an opportunity to respond to the OLA report.

Sincerely,

A handwritten signature in black ink, appearing to read "Jim Schowalter".

Jim Schowalter
Commissioner

June 8, 2012

Mr. James R. Nobles
Legislative Auditor
First Floor, Centennial Building
658 Cedar Street
St. Paul, MN 55155

Dear Mr. Nobles:

Thank you for the opportunity to respond to the finding and recommendation as a result of the audit of agency transactions and processes during the 2011 shutdown period. The report indicates one finding pertaining to the Department of Employment and Economic Development.

Audit Finding 3: The Department of Employment and Economic Development inaccurately compensated an employee during the shutdown.

Recommendation:

- *The department should recover the unauthorized compensation.*

Response: The department agrees with the finding and recommendation. The department would like to point out that a formal internal control risk assessment for the payroll cycle was completed prior to the state shutdown. During the shutdown period, the department's payroll supervisor properly compared the critical employee list to time records authorized for payment. A revision form authorizing Family Medical Act sick pay was completed after the shutdown. An oversight resulted in the isolated improper payment. The department has implemented a repayment plan to recover the unauthorized compensation. The department considers this finding resolved and no further action will be taken.

If you have any questions or need additional information, please contact Cindy Farrell at 651-259-7085 or Cindy.Farrell@state.mn.us.

Sincerely,



Mark Phillips
Commissioner

MINNESOTA • REVENUE

June 11, 2012

James R Nobles
Legislative Auditor
Office of the Legislative Auditor
658 Cedar Street
140 Centennial Office Building
St. Paul, Minnesota 55155-1603

Dear Mr. Nobles:

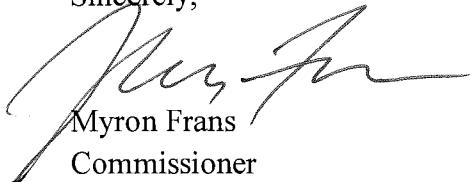
This is in response to your request regarding the impact of recommendations of the Office of Legislative Auditor (OLA) made in connection with its evaluation of the Department of Revenue's internal controls and compliance for the July 2011 state government shutdown.

Finding 2 in the report stated "certain agencies may not have adequately followed procedures related to the oversight and review of shutdown activities". It goes on to say the Department of Revenue "stated they identified shutdown risks and control activities as part of identifying critical priority services; however, they did not document these risks or the key control activities identified to mitigate these risks. Staff told us their normal, internal control activities, which they maintained during the shutdown, were sufficient to ensure transactions were authorized and appropriate."

We appreciate the Auditor's concern for ensuring proper internal controls, especially during the unique circumstances of a state government shutdown. During the shutdown the Department retained all the staff required to continue its existing internal controls for financial activities; controls that had previously been determined to be adequate. During and after the shutdown, the Department utilized its existing internal controls maintained for financial activities to ensure the propriety of all financial transactions. The Commissioner of Management and Budget communicated his expectations that all agencies maintain strong internal controls during the shutdown and the Department of Revenue fully complied with that prudent directive. The Department did not take the extra step of documenting that we held internal conversations and reached a decision to maintain all of the existing and fully documented internal controls.

We appreciate the review by and recommendations of the legislative auditor.

Sincerely,



Myron Frans
Commissioner

Commissioner's Office
600 North Robert Street
St. Paul, MN 55146