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OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Financial Audit Division Report

Office of the State Auditor

January 1, 2003, through December 31, 2004



MAY 12, 2005

05-28

Financial Audit Division

The Office of the Legislative Auditor (OLA) is a professional, nonpartisan office in the legislative branch of Minnesota state government. Its principal responsibility is to audit and evaluate the agencies and programs of state government (the State Auditor audits local governments).

OLA's Financial Audit Division annually audits the state's financial statements and, on a rotating schedule, audits agencies in the executive and judicial branches of state government, three metropolitan agencies, and several "semi-state" organizations. The division also investigates allegations that state resources have been used inappropriately.

The division has a staff of approximately forty auditors, most of whom are CPAs. The division conducts audits in accordance with standards established by the American Institute of Certified Public Accountants and the Comptroller General of the United States.

Consistent with OLA's mission, the Financial Audit Division works to:

- Promote Accountability,
- Strengthen Legislative Oversight, and
- Support Good Financial Management.

Through its Program Evaluation Division, OLA conducts several evaluations each year.

OLA is under the direction of the Legislative Auditor, who is appointed for a six-year term by the Legislative Audit Commission (LAC). The LAC is a bipartisan commission of representatives and senators. It annually selects topics for the Program Evaluation Division, but is generally not involved in scheduling financial audits.

All findings, conclusions, and recommendations in reports issued by the Office of the Legislative Auditor are solely the responsibility of the office and may not reflect the views of the LAC, its individual members, or other members of the Minnesota Legislature.

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OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

Senator Ann H. Rest, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

The Honorable Patricia Anderson
State Auditor

We conducted an audit of the Office of the State Auditor for the period January 1, 2003, through December 31, 2004. Our audit scope included appropriation control, audit practice revenue, payroll, and other administrative expenditures. Our objectives focused on a review of the Office of the State Auditor's internal controls over these financial activities and its compliance with applicable legal provisions.

The enclosed Report Summary highlights our overall audit conclusions. The specific audit objectives and conclusions for each area are contained in the individual chapters of this report.

We would like to thank staff from the Office of the State Auditor for their cooperation during this audit.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: March 29, 2005

Report Signed On: May 9, 2005

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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
Jim Riebe, CPA	Audit Manager
Joan Haskin, CPA, CISA	Auditor-in-Charge
Pat Ryan	Auditor

Exit Conference

We discussed the results of the audit with the following staff of the Office of the State Auditor at an exit conference on May 3, 2005:

Patricia Anderson	State Auditor
Matthew Lindemann	Assistant State Auditor
Tom Karlson	Manager of Standards and Procedures

Report Summary

Overall Conclusion:

- The Office of the State Auditor (OSA) spent its state appropriation within its established authority. OSA adequately safeguarded assets and properly recorded financial activities in the state's accounting system. OSA complied with applicable financial related legal provisions for the items tested.

The audit report did not contain any findings relating to internal control or compliance with financial-related legal provisions. OSA resolved a prior finding pertaining to recovering its audit practice costs.

Audit Scope:

Audit Period:

January 1, 2003 – December 31, 2004

Selected Audit Areas:

- Appropriation Control
- Audit Practice Receipts
- Payroll and Other Administrative Expenditures

Agency Background:

OSA was established by Article V of the State Constitution and operates under *Minnesota Statutes 2004*, Chapter 6. Minnesota voters elect the State Auditor to a four-year term. The current State Auditor, Patricia Anderson, began her term on January 6, 2003.

The mission of OSA is to ensure financial integrity, accountability, and cost-effectiveness of Minnesota's local governmental entities. OSA's activities are financed primarily through General Fund appropriations. OSA's appropriation in fiscal year 2004 totaled approximately \$8.3 million. The audit practice receipts collected from local units of government are deposited in the General Fund as nondedicated receipts.

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Chapter 1. Introduction

The Office of the Legislative Auditor audits all constitutional officers every two years according to a Legislative Audit Commission policy. We conduct our audits at the mid-point and at the end of each constitutional officer's term.

Agency Overview

The Office of the State Auditor (OSA) was established by Article V of the State Constitution and operates under *Minnesota Statutes 2004*, Chapter 6. Minnesota voters elect the State Auditor to a four-year term. Patricia Anderson is the current State Auditor. She began her term on January 6, 2003. The State Auditor serves on the State Executive Council, State Board of Investment, Land Exchange Board, Minnesota State Housing Finance Agency Board, Public Employees Retirement Association Board, and the Rural Finance Authority Board.

OSA is divided into six divisions:

- The Constitutional Office Division oversees the operation of the Office of the State Auditor.
- The Audit Practice Division conducts financial and legal compliance audits of some counties; the cities of Duluth, Minneapolis, and St. Paul; and organizations affiliated with counties and cities. In addition, this division annually reviews approximately 450 single audit reports submitted by cities, counties, school districts, nonprofit agencies, and other agencies for compliance with federal requirements and generally accepted government auditing standards.
- The Government Information Division promotes financial accountability and cost effective public services in local governments. The division prescribes the chart of accounts and reporting requirements for cities and towns.
- The Special Investigations Division promotes integrity and accountability in local government by investigating allegations of financial wrongdoing.
- The Pension Division monitors investment, financial, and actuarial reporting for public pension funds to ensure financially stable retirement systems and compliance with Minnesota statutes governing these activities.
- The Tax Increment Financing Division audits and monitors the financial condition and legal compliance of tax increment financing districts throughout the state. The division collects and analyzes financial information that local governments are required to report annually regarding their use of tax increment financing.

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OSA's activities are financed primarily through General Fund appropriations. OSA's appropriations for fiscal years 2003, 2004, and 2005 after budget reductions were \$9.8 million, \$8.3 million, and \$8.3 million, respectively. We discuss appropriations more fully in Chapter 2.

Minnesota Statutes 2004, Section 6.58 requires that OSA collect fees from audited organizations to cover its audit costs. The Audit Practices Division bills the political subdivisions it audits based on a fee schedule that OSA adjusts annually if necessary. According to *Minnesota Statutes 2004*, Section 16A.6701, the fees collected for audit services are deposited in the General Fund. We discuss the audit practice revenue in Chapter 3.

OSA incurs administrative costs in carrying out its statutory responsibilities. Payroll is the most significant administrative cost. Other material costs include rent, supplies and equipment, and travel. We discuss OSA expenditures in Chapter 4.

Table 1-1 summarizes the financial activity of OSA for fiscal year 2004.

Table 1-1
Summary of OSA Financial Activity
Fiscal Year 2004

<u>Sources:</u>	
General Fund:	
Operating Appropriation	\$8,306,000
Less Appropriation Reduction	(155,000)
Net Appropriation	8,151,000
Balance Forward In	339,967
Transfer In – TIF Account ⁽¹⁾	922,708
Balance Forward In – TIF Account ⁽¹⁾	298,597
Special Revenue Fund:	
Dedicated Revenue ⁽²⁾	27,035
Balance Forward In	1,940
Total Sources	<u>\$9,741,247</u>
<u>Uses:</u>	
Expenditures:	
Payroll	\$7,704,040
Rent	338,273
Travel, In-State	102,483
Supplies	100,939
Capital Equipment	70,124
Miscellaneous Expenditures	345,429
Total Expenditures	<u>\$8,661,288</u>
Other Uses:	
Balance Forward Out – General Fund	\$1,079,183
Balance Forward Out – Special Revenue Fund	733
Transfer Out – Special Revenue Fund	43
Total Other Uses	<u>\$1,079,959</u>
Total Uses	<u>\$9,741,247</u>

Notes:

(1) *Minnesota Statutes 2004*, Section 469.177, subd. 11 created the Tax Increment Finance Division (TIF). The division received funding from a .36 percent charge on TIF districts in fiscal year 2004. The Treasury Division of the Department of Finance collects the funds, deposits the money in the General Fund, and then transfers the funds to OSA.

(2) Dedicated revenue is collected for seminar and workshop activities.

Source: Minnesota Accounting and Procurement System.

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Audit Approach

Our audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we obtain an understanding of the office's internal controls relevant to the audit objectives. We used the guidance contained in *Internal Control-Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission, as our criteria to evaluate office controls. The standards also require that we plan the audit to provide reasonable assurance that the office complied with financial-related legal provisions that are significant to the audit. In determining the office's compliance with legal provisions, we considered requirements of laws, regulations, contracts, and grant agreements.

To meet the audit objectives, we gained an understanding of the office's financial policies and procedures. We considered the risk of errors in the accounting records and noncompliance with relevant legal provisions. We analyzed accounting data to identify unusual trends or significant changes in financial operations. We examined a sample of evidence supporting the agency's internal controls and compliance with laws, regulations, contracts, and grant provisions.

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Chapter 2. Appropriation Control

Chapter Conclusions

OSA complied with appropriation laws and operated within its legally authorized funding level. Expenditures were recorded properly on the state's accounting system. Residual funds were canceled or carried forward as required by law.

Background

OSA received funding for its operations through a General Fund appropriation. The office allocates the appropriation to six operating divisions and accounts for expenditures by division. Table 2-1 summarizes financial activity for these divisions for fiscal year 2004.

Table 2-1
Summary of General Fund Appropriation
Allocation for Fiscal Year 2004

<u>Division</u>	<u>Appropriation</u>	<u>Balance Forward In⁽¹⁾</u>	<u>Amount Expended⁽²⁾</u>	<u>Balance Forward to FY 2005</u>
Audit Practice (includes Single Audit)	\$5,882,145	\$189,828	\$5,635,668	\$436,305
Government Information	596,512	5,674	581,451	20,735
Operations Management	592,027	0	587,304	4,723
Special Investigations	417,069	42,070	380,136	79,003
Constitutional Office	297,383	13,347	308,022	2,709
Pension	<u>427,864</u>	<u>89,048</u>	<u>498,680</u>	<u>18,233</u>
Total Appropriation	<u>\$8,213,000</u>	<u>\$339,967</u>	<u>\$7,991,261</u>	<u>\$561,708</u>

Note 1: The Legislature allowed agencies to carry forward balances into the next biennium due to the state's budget problems.

Note 2: The amount expended for the Special Investigations and Pension divisions includes transfers out of \$2,000 and \$60,000, respectively.

Source: Minnesota Accounting and Procurement System.

The portion of OSA's appropriation that is spent on oversight of police and fire pension funds and the government information function reduces police and fire state aid and local government aid administered by the Department of Revenue. OSA certifies to the Department of Revenue costs related to the government information function for a reduction in local government aids as specified in *Minnesota Statutes 2004*, Section 477A.014, subd. 4. The local government aid offset is limited to \$217,000 per year. OSA also certifies costs related to the Pension Division to the Department of Revenue in accordance with *Minnesota Statutes 2004*, Section 69.021, subd. 5. The Department of Revenue reduces police and fire state aids by the amount of OSA

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costs associated with audits or examinations of the police and firefighters relief associations. For fiscal year 2004, OSA certified projected costs for firefighter and police relief oversight of \$295,273 and \$2,082, respectively.

In addition to the General Fund appropriation, OSA receives funding for the cost of examining the use of tax increment financing (TIF). Pursuant to *Minnesota Statutes 2004*, Section 469.177, subd. 11, the TIF division received funding from a .36 percent charge on tax increment financing districts in fiscal year 2004. The Treasury Division of the Department of Finance collects the funds from the county treasurers, deposits the money in the General Fund, and subsequently transfers the funds to OSA. TIF revenue collections in fiscal year 2004 totaled \$922,708. Total TIF division expenditures in fiscal year 2004 were \$703,830. The division carried forward \$517,475 to fiscal year 2005.

Audit Objectives

Our audit of OSA appropriations addressed the following questions:

- Did the office comply with appropriation laws?
- Were expenditures properly recorded in the accounting system?
- Were residual funds canceled, carried over, or transferred as required by law?

There were no findings in the appropriation control area.

Chapter 3. Audit Practice Revenues

Chapter Conclusions

OSA's internal control structure helped ensure that audit practice transactions were billed at the approved rate and accurately recorded in the accounting records. The office adequately safeguarded audit practice receipts. For the items tested, OSA complied with material finance-related legal provisions regarding audit practice receipts.

Audit Objectives

Our review of audit practice revenues focused on the following questions:

- Did the office's internal controls help ensure that receipt transactions were billed at the proper rate and accurately reported in the accounting records?
- Were audit practice receipts adequately safeguarded?
- Did the office comply with material finance-related legal provisions regarding receipts?

Background

OSA conducts financial and compliance audits of local governments in Minnesota. OSA bills local governments for associated audit costs. OSA deposits audit practice receipts into the General Fund. These receipts are not available for expenditure by OSA, as its spending is limited to the appropriation authority discussed in Chapter 2.

Minnesota Statute 2004, Section 6.58 requires OSA to review and adjust the schedule of charges for audit examinations at least annually to ensure that the amount collected is sufficient to pay all costs connected with such examinations. OSA sets the rate based on estimated costs. The Department of Finance approved rate increases of 9.7 percent in calendar year 2004 and 4 percent in 2005. During our review, we found that the office under-recovered audit costs by approximately \$200,000 for fiscal year 2004, which was about 3.5 percent of expenditures. The office incorporated the under-recovered amount when establishing fees for the next year.

In fiscal year 2004, OSA collected approximately \$6.1 million in audit practice revenues. OSA bills audit clients for audit work on a monthly basis. The basis for billing a client includes approved hourly audit charges and travel costs. OSA has the authority to charge interest on delinquent accounts of undisputed bills that are 60 days past due.

There were no findings as a result of our work in this area.

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Chapter 4. Payroll and Other Administrative Expenditures

Chapter Conclusions

OSA's internal control structure helped ensure that payroll and other administrative expenditure transactions were proper and accurately recorded in the accounting records. The office accurately allocated expenditures to the appropriate divisions. OSA complied with applicable finance-related legal provisions and bargaining unit agreements for the items tested.

Background

OSA incurs administrative expenditures for personnel services, travel, supplies and equipment, rent, and other miscellaneous categories. Personnel services represented approximately 89 percent of total expenditures or about \$7.7 million in fiscal year 2004. Travel, rent, and supplies and equipment represented the majority of other administrative expenditures. We discuss payroll and other administrative expenditures in the following sections.

Payroll

OSA employs about 123 staff located in offices throughout the state. The employees are covered by various bargaining unit agreements. OSA administers a separate personnel plan for those employees not covered by the bargaining unit agreements. Table 4-1 highlights the types of payroll expenditures for fiscal year 2004.

**Table 4-1
Payroll Expenditures
Budget Fiscal Year 2004**

<u>Payroll Type</u>	<u>Amount</u>
Full-time Salaries	\$7,261,097
Part-time Salaries	145,505
Overtime	106,250
Severance/Vacation Payoffs/Other	<u>191,187</u>
Total Payroll	<u>\$7,704,039</u>

Sources: OLA summary of expenditures for budget fiscal year 2004 through December 31, 2004.

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Bi-weekly payroll transactions and pay rate changes are processed through the state's payroll system. These transactions are also recorded in the state's accounting system through a computer system interface.

Audit Objective

The primary objective of our audit of payroll was to answer the following questions:

- Did the office's internal control structure help ensure that payroll expenditure transactions were accurately reported in the accounting records?
- Were employees paid in accordance with finance-related provisions of state bargaining unit agreements?
- Did the office comply with finance-related legal provisions over payroll?

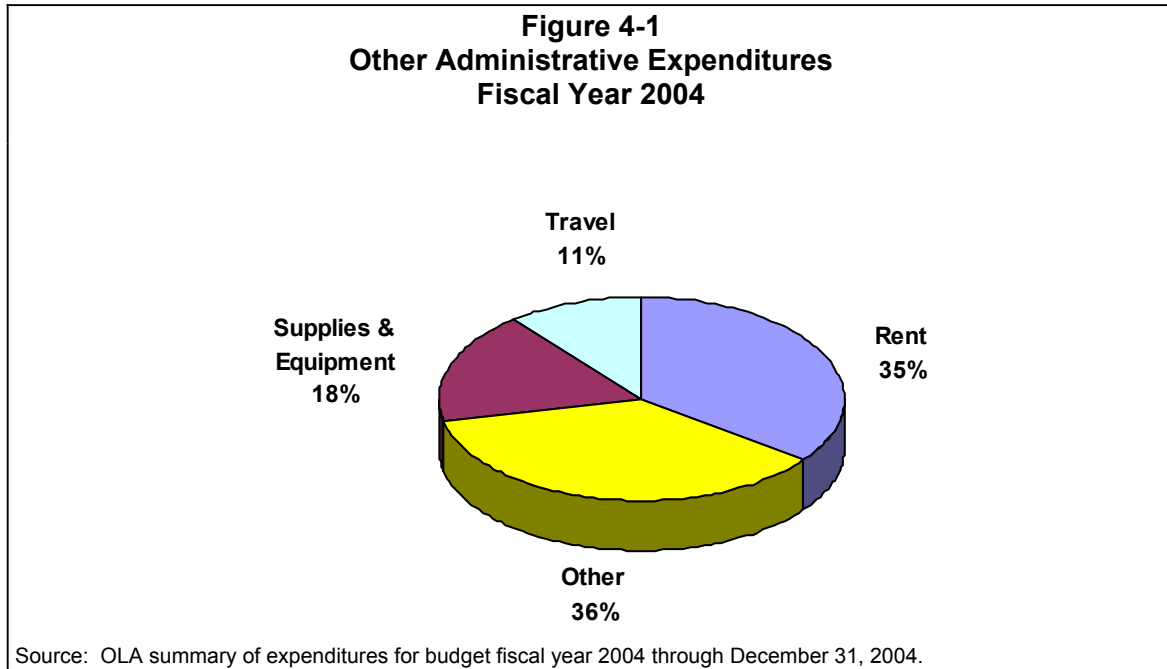
There were no findings in the payroll area.

Other (Nonpayroll) Administrative Expenditures

Other administrative expenditures accounted for approximately \$1.1 million or 11 percent of total operating costs. OSA incurred various administrative expenditures, such as rent, travel, supplies and equipment, as well as other miscellaneous categories.

The largest nonpayroll expenditure is for the lease of office space. The Real Estate Management Division of the Department of Administration assists OSA in negotiating lease agreements. The office terminated five lease agreements during fiscal year 2004 due to budget reductions and is currently leasing office space for employees in St. Paul and six other locations throughout the state. In fiscal year 2004, the office paid approximately \$338,000 for office and storage space rent.

Figure 4-1 illustrates the fiscal year 2004 nonpayroll administrative expenditures by type. The miscellaneous category is comprised mainly of professional/technical services, postage, and printing expenses.



Audit Objective

The primary objective of our audit of other administrative expenditures was to answer the following questions:

- Did the office’s internal control structure help ensure that administrative expenditure transactions were accurately reported in the accounting records and processed in accordance with management’s authorization?
- Were costs charged to the appropriate division?
- Did the office comply with material finance-related legal provisions?

There were no findings in the other administrative expenditures area.

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**Status of Prior Audit Issues
As of March 29, 2005**

May 2003 Legislative Audit Report 03-23 covered the two years ended December 31, 2002. The scope of the audit included appropriation control, audit practice revenues, personnel services, and other administrative expenditures. There was one finding that OSA did not recover its audit practice costs in fiscal years 2001 and 2002, as required by *Minnesota Statute 2004*, Section 6.58. OSA resolved the finding by adjusting its billing rates in calendar year 2004 and 2005 to materially recover all costs.

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 metropolitan agencies or the State Agricultural Society, the state constitutional officers, or the judicial branch.