OLA

OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Financial Audit Division Report

Department of Commerce
Fiscal Year Ended June 30, 2004

MARCH 3, 2005 05-14

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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If you have comments about our work, or you want to suggest an audit, investigation, or evaluation, please contact us at 651-296-4708 or by e-mail at auditor@state.mn.us

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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
Brad White, CPA, CISA	Audit Manager
Ken Vandermeer, CPA	Auditor-in-Charge
Scott Tjomsland, CPA	Team Leader
Laura Peterson, CPA	Auditor
George Deden, CPA	Auditor

Exit Conference

We discussed the findings and recommendations with the following representatives of the Department of Commerce at an exit conference on February 16, 2005:

Glenn Wilson	Commissioner
Edward Garvey	Deputy Commissioner
Mike Blacik	Assistant Commissioner
Mim Stohl	Chief Financial Officer
Dennis Munkwitz	Financial Services Director
Mark Kaszynski	Administrative Management Director
Darin Teske	Energy Assistance Supervisor

Department of Commerce

Report Summary

Key Findings:

- The department did not reconcile unclaimed property investment activity, and one individual performed incompatible financial duties for the program. (Finding 1, page 3)
- The department did not ensure that two recipients of Low Income Home Energy Assistance funding resolved ongoing financial management weaknesses identified in annual audits. (Finding 2, page 4)

The audit report contained two audit findings relating to internal control or legal compliance.

Audit Scope:

Programs material to the State of Minnesota's financial statements and to federal program compliance for fiscal year 2004.

Selected Audit Areas:

- Unclaimed Property Assets
- Low Income Home Energy Assistance Program (CFDA #93.568)

Background:

The Department of Commerce managed unclaimed property cash and investments totaling $37.8 million as of June 30, 2004. Expenditures for the federal Low Income Home Energy Assistance Program totaled $74 million for fiscal year 2004.

OFFICE OF THE LEGISLATIVE AUDITOR
State of Minnesota • James Nobles, Legislative Auditor

Representative Tim Wilkin, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Glenn Wilson, Commissioner
Department of Commerce

We have performed certain audit procedures at the Department of Commerce as part of our audit of the financial statements of the State of Minnesota for the year ended June 30, 2004. We also have audited a federal financial assistance program administered by the Department of Commerce as part of our audit of the state's compliance with the requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement*. We emphasize that this has not been a comprehensive audit of the Department of Commerce.

The scope of our work at the Department of Commerce included financial activities of the Unclaimed Property Program recorded in the state's General Fund. Unclaimed property cash and investments totaled $37.8 million as of June 30, 2004. We performed certain audit procedures on this Department of Commerce program as part of our objective to obtain reasonable assurance about whether the State of Minnesota's financial statements for the year ended June 30, 2004, were free of material misstatement.

Table 1 identifies a State of Minnesota major federal program administered by the Department of Commerce. We performed certain audit procedures on this program as part of our objective to obtain reasonable assurance about whether the State of Minnesota complied with the types of requirements that are applicable to each of its major federal programs.

Table 1
Major Federal Program Administered by the Department of Commerce
Fiscal Year 2004
(in thousands)

CFDA #	Program Name	Federal
93.568	Low Income Home Energy Assistance	$74,414

Source: *State of Minnesota Financial and Compliance Report on Federally Assisted Programs* for fiscal year 2004.

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

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Department of Commerce

Conclusions

Our November 19, 2004, report included an unqualified opinion on the State of Minnesota's basic financial statements for fiscal year 2004. In accordance with *Government Auditing Standards,* we also issued our report, dated November 19, 2004, 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 each major federal program and internal control over compliance in accordance with OMB *Circular A-133*.

As a result of our procedures, we identified the following weaknesses in internal controls and noncompliance items at the Department of Commerce.

Findings and Recommendations

1. The department did not properly control unclaimed property investments.

The Department of Commerce did not reconcile unclaimed property investment activity, and it did not separate incompatible duties for one individual responsible for account activity. Without effective controls, unclaimed property assets are vulnerable to theft, and errors could occur and remain undetected.

The department did not compare its unclaimed property computerized database (IDEA) to actual unclaimed assets, such as cash and securities, held in its bank trust account as of June 30, 2004. The department had developed a reconciliation that required a manual comparison of each investment maintained in IDEA to individual items recorded by the bank. Because the reconciliation was very labor intensive, staff did not keep it up-to-date, especially after receiving a large volume of unclaimed investments from two insurance companies during fiscal year 2004.

Another concern resulted from one individual who performs incompatible functions for the unclaimed property program. The same individual who updates the accounting records also has access to paper stock certificates received from the bank or a list of securities that the bank transferred through the Depository Trust custodian. In addition, this same individual authorizes claims and removes the unclaimed cash or investment items from the IDEAS system when a rightful owner is identified and makes a claim. Authorizing transactions and custody of assets are not typically performed by the same person accounting for the activity since they are able to both perpetrate an error and conceal it in the normal course of their duties. Alternatively, if the duties cannot be separated due to staff constraints, someone independent should review and approve the employee's work.

Recommendation

- *The department should reconcile the investment activity in IDEA to bank records on a periodic basis. In addition, the department should segregate incompatible functions or, at a minimum, have an independent person review the employee's work.*

2. The department did not ensure that two subrecipient organizations resolved internal control concerns reported in local audits.

The Department of Commerce did not ensure that two subrecipient entities timely submitted annual financial and compliance audit reports, and that the entities took corrective action on issues reported for the Low Income Home Energy Assistance (CFDA #93.568) program. The external audits, received four and seven months late, disclosed unresolved ongoing weaknesses in the general financial management practices of two Indian tribes that distribute heating assistance. The tribes continued to receive federal funding from the department, individually totaling $1,062,272 and $835,060 for fiscal year 2004, even though these audit concerns have not been resolved.

Federal regulations require the department to monitor audits of subrecipient organizations for appropriate and timely corrective action on all audit findings. To enforce such provisions, the department has the authority to impose sanctions and discontinue federal program funding. Poor financial management creates special risks and vulnerabilities that can result in inappropriate transactions or fraud. In addition, significant weaknesses in the management of the federal programs could compromise the ability of the subrecipient to deliver an appropriate level of service to eligible recipients.

Recommendation

- *The department should evaluate the inability of these subrecipient organizations to file timely annual audit reports and address ongoing financial management concerns identified in those audits. It should explore ways to rectify the problems, including consultation with the federal cognizant agency and possible sanctions on future funding.*

This report is intended for the information of the Legislative Audit Commission and the management of the Department of Commerce. This restriction is not intended to limit the distribution of this report, which was released as a public document on March 3, 2005.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: December 23, 2004

Report Signed On: February 25, 2005

Status of Prior Audit Issues
As of December 23, 2004

Fiscal Year 2003 Statewide/Single Audit

We examined the department's activities and programs material to the *State of Minnesota's Comprehensive Annual Financial Report* for the fiscal year ended June 30, 2003. The scope of our work included assets of the state Unclaimed Property Program and expenditures for the federal Low Income Home Energy Assistance Program. The purpose of the audit was to render an opinion on the State of Minnesota's financial statements for fiscal year 2003. We issued an unqualified opinion on the *State of Minnesota's Comprehensive Annual Financial Report* for the year ended June 30, 2003. This audit had no findings regarding internal controls or legal compliance.

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.

MINNESOTA
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February 23, 2005

James Nobles, Legislative Auditor
Room 140 Centennial Building
658 Cedar Street
St. Paul, Minnesota 55155-1603

Dear Mr. Nobles:

Thank you for your recent audit of the Department of Commerce programs relating to Unclaimed Property and Low Income Home Energy Assistance. We understand the importance of regularly auditing these important programs, and we appreciate the effort you and your staff invested in the audit. As with all audits and reviews, we welcome your guidance and we will implement your recommendations.

The Department of Commerce responses to the audit findings follow. Dennis Munkwitz will be responsible for implementing our response to Finding #1. The findings will be resolved by June 30, 2005. John Harvanko will be responsible for implementing our response to Finding #2. The findings will be resolved by November 30, 2005.

Recommendation #1: The department should reconcile the investment activity in IDEA to bank records on a periodic basis. In addition, the department should segregate incompatible functions or, at a minimum, have an independent person review the employee's work.

Response #1: The Department of Commerce will comply with this recommendation.

The department has begun work to improve the reconciliation process for the investment activity. We are in the process of converting a manual reconciliation process into a query-driven process that will significantly reduce the amount of time required to complete the reconciliation and keep it up to date. We have removed the reconciliation process responsibility from unclaimed property staff and assigned it to the department's financial management unit.

The department is reviewing the security profiles of the unclaimed property unit staff and, to the degree possible with the limited staff resources, will implement the changes needed to segregate incompatible functions. In addition, the department and our banking partner have recently adopted a new procedure for handling paper stock certificates. We expect that by December 31, 2005 up to 90% of paper stock certificates will be converted to direct registration shares statements. The department has already experienced a dramatic decrease in the numbers of paper stock certificates received.

Recommendation #2:
The Department should evaluate the inability of these subrecipient organizations to file timely annual audit report and address ongoing financial management concerns identified in those audits. It should explore ways to rectify the problems, including consultation with the federal cognizant agency and possible sanctions on future funding.

Response #2:
The Department of Commerce will comply with this recommendation.

In October of 2004, the department began closely monitoring both subrecipient organizations. We have made special monitoring visits to each, including multiple visits to one of the agencies. The visits have focused on program policy compliance.

The department has authority to impose penalties or to terminate contracts with the local service providers for failure to provide timely audit reports, or for failure to address the financial management concerns identified in the audits.

The LIHEAP director has discussed these issues with the Director of the Division of Energy Assistance, Office of Community Services, U.S. Department of Health and Human Services. The federal director offered several suggestions that the Department is currently assessing.

The department will require the local service providers to comply with federal and state laws and policies, and with contractual requirements, by the close of the federal fiscal year on September 30, 2005. We will require them to provide audit reports, and to comply with the audit findings.

Thank you again for the time and effort you and your staff invested in auditing the Department of Commerce. Your staff conducted the audit with professionalism and respect. We enjoyed working with everyone. We look forward to working with you again.

Sincerely,

Glenn Wilson

Glenn Wilson, Commissioner