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OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Financial Audit Division Report

Board of Public Defense

July 1, 2001, through June 30, 2004



September 1, 2005

05-47

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.

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OFFICE OF THE LEGISLATIVE AUDITOR

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Board of Public Defense

Members of the Board of Public Defense

Mr. Kevin Kajer, Chief Administrator
Board of Public Defense

We conducted an audit of the Board of Public Defense for the period July 1, 2001, through June 30, 2004. Our audit scope included payroll and grants. Our objectives focused on a review of the board'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 Board of Public Defense 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: June 3, 2005

Report Signed On: August 30, 2005

Board of Public Defense

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Audit Participation

The following members of the Office of the Legislative Auditor prepared this report:

Claudia Gudvangen, CPA	Deputy Legislative Auditor
Cecile Ferkul, CPA, CISA	Audit Manager
Tony Toscano	Auditor-in-Charge
Pat Ryan	Auditor
Marisa Isenberg	Auditor

Exit Conference

We discussed the results of the audit with Kevin Kajer, the Board of Public Defense's Chief Administrator, at an exit conference on August 23, 2005.

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Report Summary

Overall Conclusion:

Generally, the Board of Public Defense's internal controls were adequate, and the board complied with material finance-related legal provisions. However, the board could improve its controls by limiting certain expenditures and access to its personnel/payroll system.

Findings:

- The board did not adequately restrict access to the state's payroll/personnel system. (Finding 1, page 6)
- The Board of Public Defense used nearly \$5,000 for a party for its retiring chief administrator. (Finding 2, page 6)

This report contains two findings related to internal control and legal compliance.

Audit Scope:

Audit Period:

July 1, 2001, to June 30, 2004

Programs Audited:

- Payroll
- Grants

Agency Background:

The Board of Public Defense is a judicial branch agency whose purpose is to provide quality criminal defense services to indigent defendants in the state of Minnesota. The board has seven members; three are appointed by the Governor and four are appointed by the Supreme Court. Public defenders handle over 185,000 cases each year. The board's fiscal year 2004 expenditures totaled approximately \$54 million. The majority of its expenditures was for payroll.

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Board of Public Defense

Chapter 1. Introduction

The Office of the Legislative Auditor selected the Board of Public Defense for audit based on an annual assessment of state agencies and programs. We used various criteria to determine the entities to audit, including the size and type of each agency's financial operations, length of time since the last audit, changes in organizational structure and key personnel, and available audit resources. Since our last audit three years ago, the board has focused on maintaining service while facing increasing case loads and budget reductions. Also, in 2003, the chief administrator retired.

Agency Overview

The Board of Public Defense is a judicial branch agency whose purpose is to provide quality criminal defense services to indigent defendants in the state of Minnesota. The board has seven members; three are appointed by the Governor and four are appointed by the Supreme Court. In fiscal year 2004, the board's staff included about 540 full-time equivalent employees; about 380 were full or part-time attorneys employed as public defenders to handle over 185,000 cases per year.

The board's main source of funding was from General Fund appropriations. The board also received limited amounts of federal and state grants, as well as reimbursements from defendants. The board's annual expenditures during the audit period averaged about \$53 million, with its largest expenditure categories being payroll and grants to counties and public defense corporations. Table 1-1 summarizes the board's General Fund sources and uses of funds for fiscal years 2002 through 2004.

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Table 1-1
General Fund Financial Sources and Uses
Fiscal Years 2002 - 2004

	<u>2002</u>	<u>2003</u>	<u>2004</u>
Sources:			
Appropriations	\$50,723,000	\$54,709,000	\$53,763,000
Appropriations Cancelled and Reverted	0	(3,399,513)	0
Balance Forward In	112,624	750,863	1,161
Transfers In	456,831	753,719	460,031
Total Sources	<u>\$51,292,455</u>	<u>\$52,814,069</u>	<u>\$54,224,192</u>
Uses:			
Payroll	\$30,841,846	\$33,899,086	\$33,988,302
Grants: Hennepin and Ramsey Counties	13,059,638	13,245,466	12,501,000
Public Defense Corporations	1,635,000	1,302,025	1,326,000
Balance Forward Out	750,863	1,161	1,426,333
Other	5,005,108	4,366,331	4,982,557
Total Uses	<u>\$51,292,455</u>	<u>\$52,814,069</u>	<u>\$54,224,192</u>

Source: Minnesota Accounting and Procurement System.

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 board'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 agency 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 department'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 Board of Public Defense'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 documents supporting the agency's internal controls and compliance with laws, regulations, contracts, and grant provisions.

Chapter 2. Payroll Expenditures

Chapter Conclusions

The Board of Public Defense designed and implemented internal controls to provide reasonable assurance that it properly compensated staff and accurately recorded payroll expenditures in the accounting system. For the items tested, except as noted below, the board complied with applicable finance-related legal provisions, compensation plans, and bargaining agreements.

However, some staff had incompatible access to the state's personnel/payroll system. In addition, the board used nearly \$5,000 for a party for its retiring chief administrator.

Audit Objectives

Our review of the Board of Public Defense's payroll expenditures focused on the following questions:

- Did the board design and implement internal controls to provide reasonable assurance that it properly compensated staff and accurately recorded payroll expenditures in the accounting system?
- For the items tested, did the board comply with significant finance-related legal provisions, compensation plans, and bargaining unit provisions concerning payroll expenditures.

Background

The Board of Public Defense's payroll and fringe benefit expenditures for fiscal years 2002 through 2004 averaged about \$33 million and comprised 63 percent of the board's total expenditures during that period. In fiscal year 2004, the board's staff included about 540 full-time equivalent employees. The board used the state's personnel/payroll system to process biweekly payroll payments. An employee in the Board of Public Defense's Administrative Services Office entered all personnel transactions into the system. Office managers at the district public defenders offices processed payroll transactions.

The board employed approximately 380 full-time and part-time attorneys. Full-time attorneys submitted timesheets each pay period to document their hours worked. Part-time attorneys worked from one-quarter time to three-quarter time for the board and received a set amount each pay period based on their experience level and an agreed-upon number of annual hours. Part-

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time attorneys also received reimbursement for private office overhead costs incurred if they met guidelines set by the board. During fiscal years 2002 through 2004, the maximum annual overhead reimbursement was \$3,000 for three-quarter time attorneys. The board adjusted this amount for attorneys who worked less than three-quarter time. Finally, part-time attorneys received additional compensation when represented defendants were able to pay a portion of the cost of the legal services. The defendant paid the courts, which passed the receipts to the board for allocation to the part-time attorneys.

Findings and Recommendations

1. Some employees had incompatible access in the state's payroll/personnel system.

The board did not adequately separate its Administrative Service office employees' access to the state's payroll/personnel system. This access gave the employees the ability to perform incompatible duties. The employees had the ability to establish employees on the personnel system and process payments to those employees in the state's payroll system. Five employees had full access to both payroll and personnel transactions. While it is often necessary and advisable to have backup employees trained to process payments in the event of vacations or staff turnover, it is excessive to have all five administrative employees, including the chief administrator, with full access to both payroll and personnel functions. Without an adequate separation of duties, errors or irregularities in payroll could occur and go undetected. If incompatible duties cannot be adequately segregated, the board needs to design alternative procedures to detect errors or irregularities should they occur.

Recommendation

- *The Board of Public Defense should limit access in the state's payroll/personnel system to better segregate incompatible payroll and personnel duties and should design detective controls for those incompatible duties that cannot be segregated due to the limited number of staff.*

2. The Board of Public Defense used nearly \$5,000 for a party for its retiring chief administrator.

In January 2003, the board of Public Defense used nearly \$5,000 of its General Fund appropriation for a party for its retiring chief administrator. The menu included a variety of appetizers for 200 guests; alcohol was available through a cash bar. The board was unable to provide a list of invited guests, but staff told us that attendees included Supreme Court justices, some legislators, and chief public defenders.

The board does not have a policy that defines acceptable employee recognition events. For executive branch agencies, the state's special expense policy explicitly excludes retirement parties as allowable special expenses. The executive branch's department head expense policy limits recognition of retiring employees to coffee and cake receptions. When authorized, a department's total annual department head allowance is \$1,500. The Board of Public Defense is

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not subject to the executive branch's special expense and department head expense policies, but by comparison, we think that \$5,000 for a retirement party was unreasonable.

In a long standing opinion, the Minnesota State Attorney General, in response to questions about employee recognition parties and celebrations by municipalities, concluded that using public funds to pay the expenses of a party that is primarily social in nature is inappropriate, and that any public benefit which resulted from the social function was too remote and speculative in nature to justify the expenditure as being for a public purpose.

Recommendation

- *The Board of Public Defense should establish a policy to define and limit appropriate types of employee recognition events.*

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Chapter 3. Grant Expenditures

Chapter Conclusions

The Board of Public Defense's internal controls provided reasonable assurance that grant expenditures were accurately recorded in the accounting system and in compliance with applicable legal provisions and management's authorization. For the items tested, the board complied with material finance-related legal provisions.

Audit Objectives

Our review of the Board of Public Defense's grants to counties and public defense corporations focused on the following questions:

- Did the board's internal controls provide reasonable assurance that grant expenditures were accurately recorded in the accounting system and in compliance with applicable legal provisions?
- For the items tested, did the board comply with significant finance-related legal provisions governing aid to counties and public defense corporations?

Background

The Board of Public Defense granted funds to the second and fourth judicial district public defense offices (Ramsey and Hennepin counties) and to five public defense corporations to provide defense services to indigent people. During fiscal years 2002 through 2004, the second and fourth judicial districts received about \$39 million, and the public defense corporations received about \$4 million. Grant expenditures were the second largest expenditure category during the audit period, comprising about 28 percent of total expenditures.

Unlike the other counties, when the state took over funding of public defense activities, the current public defenders in Hennepin and Ramsey counties remained county employees. Beginning January 1, 1999, any new public defender employees hired by Hennepin or Ramsey counties become state employees. The board funds the public defender costs in these counties. Hennepin County received approximately \$9 million annually, and Ramsey County received approximately \$4 million annually for these costs. The counties each receive the majority of their funding at the beginning of each fiscal year and report their expenditures to the board on a monthly basis.

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The board has been unable to negotiate written grant agreements with Hennepin County. A grant agreement would document the terms that the parties agreed to, including the amount granted, financial reporting requirements, expense documentation requirements, and the disposition of funds remaining at the end of the grant period. Each fiscal year, the board disbursed funds to Hennepin County without a written grant agreement documenting the arrangement. The board did receive financial reports from the county showing how it spent the funds.

The board also granted funding to five public defense corporations in each of the years covered by our audit. The amount of the grants ranged from \$120,000 to \$443,500. The grant amounts are based, in part, on budget requests submitted by the public defense corporations. The corporations were required to report their expenditures monthly to the board, as well as show evidence of providing a ten percent match to the funding received from the board.

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Status of Prior Audit Issues As of June 3, 2005

Legislative Audit Report 02-39, issued in June 2002, covered the three fiscal years ending June 30, 2001. The audit scope included payroll, grants, and other administrative expenditures. The report contained four audit findings. One finding addressed how the board could improve its grant administration. The recommendation was substantially implemented; however, as noted in Chapter 3, the board has been unable to negotiate a written grant agreement with Hennepin County. We did not follow up on the status of the remaining three findings since they were not within the scope of our current audit.

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.

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**STATE OF MINNESOTA
BOARD OF PUBLIC DEFENSE**

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August 24, 2005

Mr. James Nobles
Office of the Legislative Auditor
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Dear Mr. Nobles:

The purpose of this correspondence is to respond the financial audit of the Board of Public Defense that your office recently completed.

Let me first complement your staff for the work that they did. They conducted the audit in a highly professional manner. In addition, our office staff appreciated the collaborative approach they took in the audit process.

As you might recall the fiscal years that were audited were a period of transition for the Administrative Services Office (ASO). Staff changes included the hiring of a new chief administrator, new budget director, and the elimination of two clerical positions, one of which was the ASO's long time personnel payroll specialist.

Overall the audit report is a positive statement for an agency with these changes and a \$54 million annual budget. As you note in your report the Board has designed and implemented proper internal controls in the payroll area. It also has internal controls in place that provide for reasonable assurance that expenditures were accurately recorded. In addition the board acted on prior audit recommendations and has a system in place for grants that complies with material finance related provisions.

In response to the specific findings;

PAYROLL

1. Some employees had incompatible access in the state's payroll/personnel system.

As you note in your report it is necessary and advisable to have backup employees trained in the event of vacations, leaves or staff turnover. As noted above, the audit period covered a period of transition for the Administrative Services Office (ASO). Also,

due to limited staffing, employees in the ASO as well as the district offices are expected to handle a variety of responsibilities.

The Board has a system for detecting errors or irregularities. Each office manager in the district public defender offices is responsible for reviewing the accounting report entitled "Payroll Posting Audit Trial" after every pay period. This report lists all employees, and what they were paid for that particular pay period. Any error or irregularity is to be reported to the Chief District Public Defender and the Administrative Services Office to be rectified.

The Administrative Services Office will review the current job responsibilities of the staff to determine if it can minimize the number of employees who have incompatible access to the payroll/personnel system.

2. The Board of Public Defense used nearly \$5,000 for a party for its retiring chief administrator.

The Administrative Services Office will be recommending to the Board a policy on employee recognition events.

Sincerely,

/s/ Kevin Kajer

Kevin Kajer
Chief Administrator

/s/ John Stuart

John Stuart
State Public Defender