O L A **OFFICE OF THE LEGISLATIVE AUDITOR**
STATE OF MINNESOTA

FINANCIAL AUDIT DIVISION REPORT

Office of the Attorney General

Internal Controls and Compliance Audit

January 2011 through June 2013

December 19, 2013 **Report 13-32**

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December 19, 2013

Senator Roger Reinert, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

The Honorable Lori Swanson
Attorney General

This report presents the results of our internal controls and compliance audit of the Office of the Attorney General for the period from January 1, 2011, through June 30, 2013. The objectives of this audit were to determine if the office had adequate internal controls for its financial operations and complied with finance-related legal requirements.

We discussed the results of the audit with the office's staff at an exit conference on December 10, 2013. This audit was conducted by Scott Tjomsland, CPA, CISA (Audit Manager), David Poliseno, CPA, CISA, CFE (Audit Manager), Susan Kachelmeyer, CPA, CISA (Auditor-in-Charge), and auditors Lori Leysen, Natalie Mehlhorn, and Heather Varez, CPA.

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

James R. Nobles
Legislative Auditor

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

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Report Summary

Conclusion

The Office of the Attorney General's internal controls were generally adequate to ensure that it safeguarded its financial resources, accurately paid employees and vendors in accordance with management's authorizations, and complied with finance-related legal provisions. However, the office had not sufficiently documented its internal controls related to security access to the state's accounting system and incorrectly categorized an expenditure in the state's accounting system.

For the items tested, the office generally complied with finance-related legal requirements. However, the office authorized three human resource transactions for which it did not have delegated authority from the Department of Management and Budget.

The office resolved all four prior audit findings.[1]

Findings

- The Office of the Attorney General allowed employees to have incompatible access to the state business systems without sufficiently documenting mitigating controls. (Finding 1, page 7)
- The Office of the Attorney General's staff processed three human resource transactions without having proper delegation of authority. (Finding 2, page 8)
- The Office of the Attorney General did not accurately categorize a transaction in the state's accounting system. (Finding 3, page 9)

Audit Objectives and Scope

<u>Objectives</u>
- Internal controls
- Finance-related legal compliance

<u>Period Audited</u>
January 1, 2011, through June 30, 2013

<u>Programs Audited</u>
- Payroll expenditures
- Travel expenditures
- Administrative expenditures
- Restitution payments
- Legal settlement and legal services receipts

[1] Office of the Legislative Auditor, Financial Audit Division Report 11-21, *Office of the Attorney General*, issued August 26, 2011.

Office of the Attorney General

Agency Overview

Article V of the *Minnesota Constitution* established the Office of the Attorney General. The office operates under *Minnesota Statutes* 2013, Chapter 8. The Attorney General is the state's chief legal officer and is elected for a four-year term. Lori Swanson was first elected in November 2006 and was re-elected in November 2010. This audit covered the first two and a half years of her second term in office.

The office received most of its funding through General Fund appropriations. Appropriations for fiscal years 2012 and 2013 were about $23.3 million each year. As authorized by statute, the office also received reimbursements from state agencies for the cost of legal services it provided to state agencies for activities not funded by the General Fund.[2] The office deposited these receipts in the General Fund as nondedicated receipts. In addition, the office collected receipts that it deposited back to the state's General Fund for registrations of charities and clubs; fines; settlements; and restitutions.[3] Payroll was the most significant administrative cost for the office. Table 1, on page 5, summarizes the office's financial activity for fiscal years 2012 and 2013.

Objective, Scope, and Methodology

The objective of our audit of the Office of the Attorney General was to answer the following questions for the period January 1, 2011, through June 30, 2013:

- Were the office's internal controls adequate to ensure that it safeguarded its financial resources, accurately paid employees and vendors in accordance with management's authorizations, complied with finance-related legal provisions, and created reliable financial data?

- Did the office comply with finance-related legal requirements?

- Did the office resolve prior audit findings?[4]

[2] *Minnesota Statutes* 2013, 8.15, subd. 5.
[3] These nondedicated receipts reverted to the General Fund and were not available to fund the office's operations.
[4] Office of the Legislative Auditor, Financial Audit Division Report 11-21, *Office of the Attorney General*, issued August 26, 2011.

To answer these questions, 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 requirements. We analyzed accounting data to identify unusual trends or significant changes in financial operations. We examined samples of transactions and evidence supporting the office's internal controls and compliance with laws, regulations, policies, and contracts.

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. As our criteria to evaluate agency controls, we used the guidance contained in the *Internal Control-Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission.[5] 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 office's internal policies and procedures as evaluation criteria over compliance.

[5] 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.

Table 1
Summary of Financial Activity
Fiscal Years 2012 and 2013[1]

Total Appropriations by Fund	2012	2013
General	$21,094,000	$21,094,000
Special Revenue	1,884,000	1,884,000
Remediation	250,000	250,000
Environmental	145,000	145,000
Total Appropriations	$23,373,000	$23,373,000
Revenues by Type		
Restitutions[2]	$46,235,199	$7,233,344
Attorney General State Fees	8,191,430	8,479,846
Settlements[3]	428,109	6,611,013
Federal Grants[4]	1,093,145	999,619
Registration of Charities	430,700	435,325
Registration of Clubs	175,775	165,350
All Other Revenues and Fees	136,051	187,598
Total Revenues	$56,690,409	$24,112,094
Expenditures by Type		
Payroll	$25,319,266	$25,794,972
Space Rental	2,642,837	2,238,655
Claims[5]	389,352	3,693,761
Computer Services[6]	404,437	914,749
Equipment[6]	91,826	931,871
Supplies[7]	178,563	745,494
Repairs to Equipment / Furniture[8]	75,645	649,720
Professional/Technical Services[9]	48,558	310,915
Travel	131,982	157,030
Other Expenditures	322,255	406,558
Total Expenditures	$29,604,721	$35,843,725

[1] The scope of our audit also included the period from January 2011 through June 2011.

[2] Restitutions collected in fiscal year 2012 included Minnesota's share (about $41.5 million) of a settlement with the country's five largest mortgage services. In February 2012, 49 state attorney generals and the federal government announced a joint state-federal settlement that provided as much as $25 billion in relief to distressed borrowers and direct payments to states and the federal government. The agreement settles a state and federal investigation finding that the country's five largest mortgage servicers routinely signed foreclosure related documents outside the presence of a notary public and without really knowing whether the facts they contained were correct. The Office of the Attorney General disbursed this money to approximately 32,000 distressed borrowers in December 2013.

[3] The majority of 2013 settlements were due to $6.1 million collected from two pharmaceutical companies for violations of consumer protection laws.

[4] The Office of the Legislative Auditor annually examines the state's major federal grants in compliance with federal audit requirements. The Office of the Attorney General received federal funds primarily for its State Medicaid Fraud Control Unit, a part of the federal Medical Assistance Program (Catalog of Federal Domestic Assistance 93.778). The Medical Assistance Program is a major federal program and was included in the scope of our federal compliance audit for fiscal years 2011 and 2012; we did not perform any additional procedures related to federal program compliance.

[5] Claims are paid to restitution claimants in accordance with court orders.

[6] Computer services and equipment expenditures increased from fiscal year 2012 to fiscal year 2013 due to a planned replacement of the office's old computer system, including data security enhancements, computers, printers, servers, and software.

[7] Supplies increased because the office renewed its law library subscriptions and incurred expenditures to support the computer replacement reported in note 6 above.

[8] Repairs to equipment increased because the office miscategorized about $566,000 it paid for certain legal subscription services as discussed in Finding 3. Those costs should have been coded to purchased services, which we would have included in Other Expenditures in this table.

[9] Professional and technological services increased because additional settlement activity in fiscal year 2013 increased the need for various third party services, such as expert testimony.

Source: The state's accounting system.

Conclusion

The Office of the Attorney General's internal controls were generally adequate to ensure that it safeguarded its financial resources, accurately paid employees and vendors in accordance with management's authorizations, and complied with finance-related legal provisions. However, the office had not sufficiently documented its internal controls related to security access to the state's accounting system and incorrectly categorized an expenditure in the state's accounting system.

For the items tested, the office generally complied with finance-related legal requirements. However, the office authorized three human resource transactions for which it did not have delegated authority from the Department of Management and Budget.

The office resolved all four prior audit findings.

The following *Findings and Recommendations* further explain the office's internal controls and compliance weaknesses.

Findings and Recommendations

Finding 1

The Office of the Attorney General allowed employees to have incompatible access to the state business systems without sufficiently documenting mitigating controls.

As of October 10, 2013, the office had not sufficiently documented internal controls to mitigate the risk created when it allowed seven employees to have incompatible access to the state's accounting system.

Three of the seven employees with incompatible access each had more than 40 combinations of incompatible security roles, based on the Department of Management and Budget's matrix of incompatible security roles. In addition, two other employees had access to incompatible personnel and payroll roles that allowed them to create and update employees' direct deposit information and enter payroll or expense reimbursements into the state's payroll system. The state policy specifically prohibits this combination of payroll roles.[6]

The office's internal control policy did not sufficiently describe the specific internal controls designed to mitigate the risks related to employees' incompatible access to the state's accounting system. The policy prohibited employees from completing all steps in a financial, purchasing, or payroll transaction; but, it did not sufficiently describe the internal controls necessary to monitor transactions employees processed.

State policy generally requires separation of incompatible duties so no one employee has control over an entire transaction or process, which could result in error or fraudulent transactions going undetected.[7] The policy also requires that if the office is unable to adequately separate incompatible duties, it must develop and document controls designed to mitigate the risk that error or fraud will not be detected. These controls typically include analysis and supervisory review of transactions processed by the employees with inappropriate access.

Recommendation

- *The office should eliminate employees' incompatible security roles or better document its internal controls in place to mitigate the risk created by the incompatible access.*

[6] Department of Management and Budget *Request for SEMA4 Security Access*, form PE-00662-25, (11/12). (SEMA4 is the part of the state's accounting system used to process human resource and payroll transactions.)
[7] Department of Management and Budget Statewide Operating Policy 1101-07.

Finding 2

The Office of the Attorney General's staff processed three human resource transactions without having proper delegation of authority.

The office continued to use a delegation of authority for three human resource transactions after the person with the primary delegation retired in October 2012. The delegation, received from the Department of Employee Relations[8] in 2008, allowed the employee to give final approval for legal secretaries' compensation rates upon initial hire and promotion to a higher classification within the legal secretary classification series.[9] As of October 2013, about 25 percent of the office's employees were in the legal secretary classification series. Since October 2012, when the employee with the delegation retired, an employee who had been previously designated as a sub-delegate under the original delegation hired three employees into positions in the legal secretary classification series. Although the office lacked delegated authority for these transactions, the compensation rates the office established were consistent with decisions made while the delegation of authority existed.

The policy requires the office to obtain new delegated authority when the employee with the delegation leaves the agency or is no longer in a position to administer the delegated authority. The state bases its delegation of authority decisions on its assessment that a specific employee has a thorough knowledge of the state's classification and compensation systems; a comprehensive understanding of human resources merit system principles; and an understanding of the concepts of classification, selection, assessment methods, and compensation administration.[10]

Recommendation

- *The office should update its delegation of authority, as required by state policy.*

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[8] In 2007, the Legislature abolished the Department of Employee Relations and transferred its duties to the Department of Finance by June 2008. The Department of Finance later became the Department of Management and Budget.

[9] Legal secretary positions are represented by the American Federation of State, County and Municipal Employees.

[10] Administrative Procedure 36 allows the employee with delegated authority to act in place of Department of Management and Budget under personnel law *Minnesota Statutes* 2013, Chapter 43A, and the Department of Management and Budget's *Delegation of Authority Policy for Classification, Selection, or Compensation.*

Finding 3

The Office of the Attorney General did not accurately categorize a transaction in the state's accounting system.

The office did not accurately categorize certain legal subscription services in the state’s accounting system. In April 2013, the office coded about $566,000 of prepaid software fees for online subscriber services as maintenance contracts rather than on-line subscriptions. The services provided by the vendor included remote access to various vendor-owned and third party databases, services, and functions. The office should have classified these costs as purchased services. Office staff told us that they believed they could not overwrite the accounting system’s default category code used for the existing contract. Because it relied on the default code setting for this transaction, the office is unable to rely on information in the accounting system as an accurate record of this transaction.

Recommendation

- *The office should ensure that it accurately codes all transactions in the state’s accounting system.*

STATE OF MINNESOTA
OFFICE OF THE ATTORNEY GENERAL

LORI SWANSON
ATTORNEY GENERAL

December 13, 2013

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Mr. James Nobles
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Dear Mr. Nobles:

Thank you for your Internal Control Compliance Audit for the period January 1, 2011 through June 30, 2013. We appreciate the thorough review undertaken by your staff. Please accept this response to the Findings and Recommendations:

Finding 1:

The Office of the Attorney General allowed employees to have incompatible access to the state business systems without sufficiently documenting mitigating controls.

Response:

The Minnesota Attorney General's Office attempts to operate as efficiently as possible and, accordingly, has a limited number of administrative staff to process accounting and personnel transactions. As a result, the Office does not have extra administrative personnel so as to be able to assign each step in the SWIFT system to a different employee, and we must sometimes provide for the non-segregated performance of functions while employees are out ill or on annual leave. MMB Policy 1101-07 provides that when it is not possible for an agency to fully segregate incompatible job functions, the agency should implement compensating controls. Policy 1101-07 further states that "compensating controls" may include, among other things, retrospective reconciliations and reviews of detailed transaction reports.

Consistent with policy 1101-07, the AGO Internal Control Policy states:

> "To ensure appropriate separation of duties, no employee is allowed to complete all the steps in a financial, purchasing, or payroll transaction...In instances where efficient use of resources requires an employee to have access that potentially allows the employee to engage in multiple functional responsibilities, the Office has established compensating controls. The Director of Finance and the Director of Legal Operations periodically review expenditure reports to verify transactions' compliance with this policy."

It should be noted that all purchases and funds have been properly accounted for, and no discrepancy has occurred with the system utilized by the Office. In cases where extra staff were not available to assist in processing transactions, the Director of Finance or I reviewed the transactions or detailed transaction reports. In addition, either he or I approved all purchase decisions and all payments on accounts payable that were processed by administrative staff.

Having said this, we appreciate your comments and when possible will involve additional administrative staff in personnel and accounting functions and, when that is not possible due to the limited size of our administrative staff, we will document with additional specificity the compensating controls utilized by the Office.

Finding 2:

The Office of the Attorney General's staff processed three human resources transactions without having proper delegation of authority.

Response:

In 2007, Minnesota Management and Budget ("MMB") delegated authority to the Attorney General's Office to establish starting rates of compensation for new legal secretaries. MMB granted this authority to the Director of Administration as the primary delegate, and to the Director of Human Resources and Human Resources Generalist as secondary delegates.

The Director of Administration retired in October, 2012. Following her retirement, the Director of Human Resources and the Human Resources Generalist—both of whom were listed as secondary delegates under the original delegation—jointly approved the starting rates of pay for three new legal secretaries. We appreciate your recognition that the compensation rates for these secretaries were consistent with past hiring decisions.

We appreciate your suggestion that we ask MMB to update the Office's delegation to denote me as the primary delegate and the Human Resources Generalist as the ongoing secondary delegate, and MMB has done so.

Finding 3:

The Office of the Attorney General did not accurately categorize a transaction in the state's accounting system.

Response:

In 2011 the State of Minnesota began to utilize the SWIFT accounting system. I appreciate your Office's comments about the difficulties that various state agencies have encountered with the SWIFT system. In April, 2013 this Office renewed its contract with Westlaw, an online legal research vendor, with the assistance of the Minnesota Department of

Administration ("DOA"). A DOA employee entered the initial contract parameters into SWIFT. Our administrative employee then entered the purchase order data. When she did so, SWIFT provided her with a default category code of "8111812 COMPUTER RELATED SERV (NOT P/T)." Among other things, the narrative for this code includes "research and technology based services." Acceptance of the default category code automatically locked the transaction to the account code of "415003 Maintenance Contracts." Attempts to override the account code produce a warning that doing so will de-reference the contract from the transaction.

We appreciate your comments and have provided additional direction to staff on how to override potentially incompatible default code settings in SWIFT.

I thank you again for your office's thorough and professional review. If you have any questions, please contact me.

Sincerely,

Elizabeth McAfee

ELIZABETH MCAFEE
Director of Legal Operations