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# STATE OF MINNESOTA

## STUDY AND RECOMMENDATION FOR TRANSFERRING THE POWERS, DUTIES AND RESPONSIBILITIES OF THE STATE TREASURER UPON COMPLETION OF HER TERM OF OFFICE IN JANUARY, 2003

**January 15, 2000**

**Prepared by:**

**The Honorable Carol C. Johnson**
**Minnesota State Treasurer**
**303 Administration Building**
**50 Sherburne Avenue**
**St. Paul, Minnesota 55155**

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# State Treasurer's Study and Recommendation for Transferring the Powers, Duties and Responsibilities of the State Treasurer upon Completion of Her Term of Office in January, 2003

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CAROL C. JOHNSON
Minnesota State Treasurer

January 15, 2000

I am pleased to submit herewith my Study and Recommendation for the transfer of powers, duties and responsibilities of the State Treasurer. This recommendation is made in compliance with 1998 Minnesota Laws, Chapter 387, Article 2, Section 1.

I have diligently studied the duties and issues surrounding the transfer of powers and believe my recommendation is in the best interest of the citizens of the State of Minnesota.

If you have questions or comments, please feel free to contact me at my office, (651) 282-5032.

Respectfully submitted,

Carol C. Johnson
Treasurer
State of Minnesota

303 Administration Building • Saint Paul, Minnesota 55155 • 651.296.7091 • Fax: 651.296.8615
Email: state.treasurer@state.mn.us • Web Site: http://www.treasurer.state.mn.us

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# Executive Summary

## Background

In the general election held in November 1998, the citizens of Minnesota voted to abolish the office of Treasurer, effective at the end of the current Treasurer's term of office in January 2003. The statute that placed the proposed amendment on the ballot directed the Treasurer, in the event the amendment passed, to recommend to the legislature an appropriate agency or constitutional office to receive the powers, duties and responsibilities of the Treasurer, together with any conditions that, in the Treasurer's opinion, should govern the transfer. The Treasurer was also required to consult with the Secretary of State and the Commissioner of Finance. This Recommendation is made in accordance with that statute.

## General Approach

To assist her in making her recommendation, the Treasurer decided to:

- Develop a clear description of the Treasurer's duties, how they relate to other state agencies, and why they are important to state government and the state's citizens;
- Determine what management principles are applicable to her recommendation, taking into consideration both the needs of good government and good financial management;
- Solicit comments from and personally meet with a cross-section of Minnesotans in the public and private sectors who are familiar with state government and financial management, and are qualified to provide to her their insight and the benefit of their experience.

## Core Function of the Office of the State Treasurer - Role in State Government

The core function of the Office of State Treasurer, and the duties comprising this function, is short-term cash management and oversight; that is, to account for the state's cash in real time throughout every business day. The State Treasurer is separate and independent from the other financial arms of government, the Departments of Finance and Revenue and the State Board of Investment. Therefore, the State Treasurer's cash management core function serves as an effective "check and balance" for the state's financial system.

The State Treasurer's office performs several unique and distinct but closely connected functions on a routine and daily basis. These functions are not duplicated elsewhere in state government and are performed through the use of banking industry equipment and technology not used elsewhere in other agencies.

To perform this cash management function, the State Treasurer's staff continually monitors and oversees the movement of money into and out of over 300 bank accounts maintained by the State Treasurer to ensure that:

- Agencies deposit money as soon as it is available;
- No money is withdrawn without authorization from the Treasurer;
- All cash is collateralized throughout the day at 110% of value as required by statute to protect the state against failure of financial institutions;
- Funds are available to pay the state's obligations each day, while maximizing the amount of cash available for investment (thereby maximizing earnings), without being overdrawn;
- The state's banks properly credit the state in a timely manner for all deposits and maturing investments;
- Discrepancies are identified and accounted for before the end of every business day on all of the state's large general bank accounts.

**State Treasurer's Short Term Cash Management Function Must Continue Within State Government**

Everyone who is familiar with the Treasurer's duties agrees that this core "short-term cash management and oversight" function is not now performed by any other agency in Minnesota government and that the core function, as described, must continue to be performed by a state agency or constitutional officer. This function is necessary for the following reasons:

- The state should maximize earnings on the state's cash reserves; it is a good business practice.
    - In FY 1999 approximately $246 billion was deposited to and withdrawn from the state's bank accounts, generating over **$200 million in earnings**. These are significant amounts of money justifying attention to detail, particularly as the electronic movement of money makes it more difficult to understand the underlying transaction in sufficient detail to discover systemic errors;
- The State Treasurer's cash management system provides to the controller (accountant) for state government (the Department of Finance) a benchmark against which the Department of Finance can determine whether the accounting system is in balance. The Department of Finance balances to Treasurer's Cash before the end of every business day;
- The state's cash is accounted for and protected until lawfully disbursed or invested;
- The state provides recognized and accepted accountability to the citizens.

The Treasurer then focused on which principles of financial and governmental management should guide her in recommending which departments or agencies should be responsible for this function.

## Sound Financial Management Principles: Government vs. Private Business

There are similarities and differences between how private industry and government each manage their financial activities. Both adhere to the same basic principles regarding the relationship between a treasurer's cash management function and a controller's accounting function. These principles are:

- Separation of duties;
- Independence (Government uses independently elected officials; private industry uses independent external audits)

Government has typically adhered to these principles by using a system of checks and balances; that is, by investing powers that need to be kept separate and independent in individuals who are elected separately and independently. For example:

- 42 of the 50 states maintain the "treasury function" in an agency separate from any other state agency associated with state government accounting activities;
- 2 of the remaining 8 states maintain the "treasury function" in an agency headed by a statewide elected official other than the Governor.

*A detailed listing is set forth in Appendix E.*

Private industry takes a more vertical approach that gives the Chief Executive Officer more control but preserves the same basic principles:

- The cash manager and the controller may both report to the same person, such as a Chief Financial Officer. However, separation and independence is preserved by using a combination of several internal control devices that may require:
  - the Internal Auditor, who reports directly to the Board of Directors or to one of its subcommittees, to monitor the company's financial management practices, including separation of duties;
  - periodic audits by independent third party CPA firms who present their findings to the Board or a subcommittee thereof;
  - the cash manager to provide periodic informational reports directly to the Board of Directors, or a subcommittee of the Board, regarding the company's cash position.
- Private businesses also typically have other built-in means of insuring the integrity of the system, such as lenders who can demand external audits and who frequently also function as the business' bank.

Not surprisingly, government is concerned about public accountability and private business is concerned about internal efficiency. Both, however, end up at the same place; that is, **the short-term cash management system is kept separate and independent from other accounting activities.**

## Conclusions

The Treasurer concluded that, on balance, her recommendation would be within the tradition of governmental checks and balances. In the end, accountability to the state's citizens is the most important and expected characteristic of a democratic form of government. The State Treasurer, as a separate and independently elected officer of the government, provides accountability and checks and balances. As noted by the Legislative Auditor in his conversation with the State Treasurer, "we have lost something", as a consequence of the decision to abolish the office of State Treasurer. The Treasurer's recommendation reflects a desire to minimize that loss as much as possible.

The Treasurer believes that it is possible to be both efficient in the use of resources and accountable to the people. We must ensure as best we can that over the next 100 years the state's financial system will not be compromised because of budgetary constraints or perceived political demands. Therefore, the Treasurer arrived at the following conclusions:

- The Treasurer's duties should be transferred to an existing governmental entity rather than being retained as a separate appointed office.

- The people of Minnesota, by their vote, did not intend that the state's financial system should in any way be compromised in order to reduce the size of government.

- The duties performed by the State Treasurer are unique and are not performed by any other agency of government, nor are they duplicated in any way.

- Physical or organizational proximity should not be a significant consideration when evaluating options because technology allows for seamless operations regardless of location.

- The financial management system of state government belongs in the executive branch of government; the Treasurer's duties should not be transferred to the legislative branch, as in some states.

- The importance of "checks and balances" within government cannot be over-emphasized.

- Transferring the duties to the Commissioner of Finance is not the best solution because it would not retain the current "checks and balances" within the state's financial management system, and because additional costs for internal audits would be incurred to ensure continued separation of duties.

- The Treasurer believes that, on balance, transferring the duties to a constitutional officer in the executive branch, specifically the State Auditor, is the best solution. The State Auditor provides an independence of function and separation of duties very similar to that which the State Treasurer currently provides. The merging of duties of the Auditor and the Treasurer is also similar to what has been occurring in many Minnesota counties.

**Recommendation**

The Treasurer recommends that upon the completion of her term as State Treasurer:

- All duties, responsibilities, and authority of the State Treasurer should be transferred to the State Auditor.
- All staff and appropriated funds should be transferred to the State Auditor.

The electronic transfer of money will continue to increase. Therefore, an annual risk assessment of the cash management electronic processing systems should be conducted to ensure they are secure for purposes of safe transmittal of large amounts of money to and from the state's bank accounts. This condition is recommended without regard to which constitutional officer or agency the Treasurer's duties are transferred.

**Additional Recommendation**

Regarding the Minnesota State Board of Investment (SBI), the Treasurer also notes that upon the completion of her term the SBI will consist of four members instead of the current five, because the Treasurer will no longer be represented as a member. In effect, in order for the SBI to change any of its policies beginning in 2003 and thereafter, it will be necessary to convince three out of four members to do so instead of three out of five, a much higher threshold indeed. The Treasurer believes that over the course of time the state and the beneficiaries of the invested pension funds would be better served if that threshold were not so difficult.

The Treasurer urges the legislature to examine ways to remedy this unfortunate situation. Over the last 141 years since statehood the state and its public employees have been served extremely well by the SBI. All five members of the SBI are elected statewide officers. The Treasurer believes that it is best to retain the same historical composition to the extent possible. The best choice would be the Speaker of the House of Representatives, an individual elected by the largest group of elected representatives within the state.

**Comments from the Honorable Mary Kiffmeyer, Secretary of State**

State Treasurer Johnson and her staff are to be commended for the detail and thoroughness of the *Study and Recommendations for Transferring the Powers, Duties and Responsibilities of the State Treasurer*. The Report is both meticulous and complete in its review of the many issues that arise out of the electorate's 1998 vote to abolish the Office of State Treasurer.

With that said, I disagree with both of the policy recommendations offered by Treasurer Johnson; namely that: (1) the powers, duties, responsibilities, appropriations, personnel and equipment of the Office of the State Treasurer be transferred to the Office of the State Auditor; and (2) the Speaker of the Minnesota House of Representatives should replace the State Treasurer on a five-member State Board of Investment. The facts, analyses and policy goals that are referenced in the Report point me to other and different conclusions. Respectfully, therefore, I dissent from these recommendations.

In my view:

(1) the State Treasurer's functions should be combined with the duties of the State Board of Investment;

(2) a fifth member, if any, of the State Board of Investment should be selected by, or accountable to, each and every voter in Minnesota; and

Lastly, the Chairmanship of the State Board of Investment Administrative Committee should rotate, on an annual basis, among the elected Board Members.

As part of my comments to the State Treasurer's Full Report, which is attached, I discuss in more detail the Treasurer's factual analysis and the rationale for my alternative proposals.

**Comments from Ms. Pam Wheelock, Commissioner of Finance**

The Department of Finance was created to consolidate and modernize the financial management functions of state government. By statute, the Commissioner is the state's controller and chief accounting and financial officer, and is responsible for the State's accounting, payroll, financial reporting, budgeting, forecasting, and debt management functions.

Contrary to the implications in the Treasurer's report, there is no inherent reason why the functions currently located in the Treasurer's office must be located in a separate constitutional office. While the report suggests that independence, accountability, and separation of duties (checks and balances) would be compromised if the functions were not located in a separate constitutional office, there is considerable evidence to the contrary.

Accountability and independent scrutiny of financial functions would be maintained with the addition of the cash management functions to an existing state agency. The cash manager's performance would be subject to regular review and poor performance could result in replacement at any time, not delayed until the next election. All large state agencies are subject to independent audit scrutiny annually by the Office of the Legislative Auditors, and internal audit units could do additional audit work if necessary.

It is clear from examination of other governmental and private entities that the organizational model of one chief financial officer, responsible for both the cash management and accounting functions, can operate efficiently without jeopardizing the financial integrity of the organization. Throughout local government, in several states, and at the federal level, in addition to private industry, this model is common and functions without compromising accountability or efficiency. This model would not be so prevalent in organizations of all sizes if it presented a risk to financial operations.

The primary purpose of the offices of the state auditor and the Secretary of State are not consistent with the Treasurer's duties. In both cases, their ability to concentrate on their primary functions would be diluted with the addition of the Treasurer's duties.

During the period 1985/86, when the duties of the State Treasurer were transferred to the Department of Finance, the Cash and Debt Management Division reported directly to the Commissioner, as did a separate division responsible for Accounting Services. This organizational structure, with cash management and accounting services in separate divisions, but reporting to the chief financial officer, functioned efficiently while maintaining independence and accountability. The Office of the Legislative Auditor raised no audit findings concerning cash management during these years.

The Department of Finance's existing expertise in state government finance, including cash management experience, will permit a smooth transition of the Treasurer's functions without additional costs. Combining these duties within the department where many closely related functions are already in operation will provide the best opportunity for realizing possible efficiencies.

The Department of Finance is the obvious location for the state's cash management as well as accounting responsibilities. The Treasurer's functions are consistent with the Department's mission of ensuring the integrity of the state's fiscal resources. The people of Minnesota will be best served by placing the Treasurer's duties with the chief financial officer of the state, the Commissioner of Finance.

<u>State Board of Investments Membership</u>

With the elimination of the treasurer's office, the board of investments will be reduced to four members. Historically, the state has been well served by a five-member board of constitutional officers. The Treasurer's seat should be replaced with the Lieutenant Governor, the only remaining constitutional officer not already on the board.

# Study and Recommendation

## I. Background

### A. History of the Office of State Treasurer

Minnesota's financial system originated with the first territorial treasurer in 1849. Four men served as territorial treasurer until Minnesota was admitted to the Union in 1858. The first state constitution created the position of State Treasurer to manage the state's funds. These basic responsibilities of the State Treasurer have not changed over the years, and are divided into the following duties:

- maintain and operate the state's cash management function,
- monitor state debt obligations and make principal and interest payments;
- maintain and balance all of state government's bank accounts (Over 300 accounts in 150 financial institutions throughout the state.);
- determine the amount of money that can be invested on a daily basis (Over $200 million was earned in FY 1999 on the state's cash on hand.);
- provide an accurate accounting of the state's cash on hand. (In FY 1999 approximately $246 billion was deposited and withdrawn from the state's bank accounts. The amount is large because money that is invested and then matures is counted each time it is re-invested.)

The current State Treasurer, the Honorable Carol C. Johnson, is Minnesota's 26th Treasurer

### B. Evolution of the Duties of the State Treasurer

It is noted that, contrary to conventional opinion, most of the accounting duties now performed by the Department of Finance had been performed, before 1973, by the State Auditor, not the State Treasurer. Separation of the cash management function from the accounting function has been a hallmark of state government's financial system since statehood.

The cost for preparing this report, including any costs incurred by another agency or another level of government: $17,025.00

Since statehood there have been two significant changes in the duties of the State Treasurer:

- In 1973, the legislature created the Department of Finance, which was given the responsibility of bidding out and negotiating the state's bank accounts. Prior to that time the State Treasurer had simply designated banking relationships. The State Treasurer remains responsible for maintaining and balancing the bank accounts. This separation and division of duties is an excellent example of effective "checks and balances."
- In 1983, the legislature transferred responsibility for Unclaimed Property from the State Treasurer to the Department of Commerce.

Developments in technology have reduced the number of people needed to perform the Treasurer's duties; however, the need for sophisticated processing and monitoring systems and for people to operate and understand them has dramatically increased.

**However, the basic functions of the State Treasurer have remained substantially unchanged over the years.**

## C. Past Studies and Reports Concerning the Office of the State Treasurer

The State Treasurer reviewed six broad-based studies and reports that have been done over the past 50 years which made recommendations about reorganizing state government. The review was done in the hope these reports would provide some insight for the Treasurer to consider when she made her recommendation. As discussed below, the reports and studies send a very mixed message and were not helpful. The main points of these reports are:

- Recommendations about the State Treasurer, or indeed about any of the constitutional offices, were usually in the context of reducing the number of **elective** offices, not eliminating the offices or their duties, *per se*.

- None of the reports focused on the State Treasurer. All of the reports seemed to acknowledge that the functions performed by the State Treasurer were a necessary part of state government, and in four of the six reports the recommendation was to retain the office as a separate entity.

- Two of the reports made no recommendation to abolish the Office of State Treasurer. (One of these two reports, the CORE Report, suggested that the roles of State Treasurer and a proposed "Secretary of Finance" should be "examined").

- Two of the four reports that advocated reducing the number of elective offices recommended eliminating **all** constitutional offices other than the Governor and the Lieutenant Governor. This is frequently called the "Federal Model." The other two reports recommended abolishing the offices of Auditor, Treasurer and Secretary of State, in one instance, and the offices of Secretary of State and Treasurer in the other.

- Of the four reports that recommended abolishing the **elective** office of State Treasurer:
  - Two reports recommended the duties be transferred to the Department of Administration;
  - Two reports recommended retaining the office as a separate office: either appointed by the Governor, in one report; or elected as a non-constitutional officer, or appointed, as determined by the legislature, in the other report.

*These studies are summarized in Appendix A to this Report. Full text copies are available in the Legislative Reference Library.*

## D. Proposed Constitutional Amendment to Abolish the Office of State Treasurer

Article IX, Section 1 of the Minnesota Constitution provides that

> *".... If a majority of all the electors voting at the (general) election vote to ratify an amendment (proposed by the legislature), it becomes a part of (the) constitution."*

During 1997 and 1998, the State Legislature discussed, debated, and passed a statute (1998 Laws, Chapter 387, Article 1, Section 1) that placed a proposed amendment to the Minnesota Constitution on the ballot to abolish the Office of State Treasurer and requiring the transfer of the State Treasurer's powers, duties, and responsibilities to an appropriate agency or constitutional office.

## E. Results of the Vote on the Constitutional Amendment to Abolish the Office of State Treasurer

The proposed amendment to abolish the Office of State Treasurer received 1,087,789 votes **(51.6%)** of the total votes cast (2,105,984) in the November 1998, election. A total of 1,018, 195 voters **(48.4%)** were either opposed (855,853) or did not vote on the amendment (162,342).

### F. Requirement to Study and Make Recommendation to the Legislature

Chapter 387, Article 2, Section 1 of the 1998 Laws requires the State Treasurer to submit a recommended plan to the Legislature by January 15, 2000, detailing where and how these functions should be transferred.

> "The state treasurer, in consultation with the secretary of state and the commissioner of finance, shall study the issue of transferring the powers, duties, and responsibilities of the state treasurer and shall recommend to the legislature an appropriate agency or constitutional office to receive them. The treasurer may also recommend any conditions that, in the treasurer's opinion, should govern the transfer. The treasurer's recommendation must be made by January 15, 2000."

### G. State Board of Investment Reduced to Four Members

Chapter 387, Article 2, Section 3 provided that if the proposed amendment passed then the State Board of Investment would not include the State Treasurer and the Board membership would be reduced to four members, the Governor, the State Auditor, the Secretary of State, and the Attorney General.

## II. State Treasurer's Approach to Arriving at a Recommendation

The Treasurer decided early in the process that she wanted her study and recommendation to include two basic discussions:

- A clear description of the duties and responsibilities of the State Treasurer;
- A set of governmental and management principles to guide the recommendation.

### A. Assistance from People Outside the Treasurer's Office

To generate the best possible information and opinions about these two discussions, the Treasurer believed it prudent and judicious to:

- Meet and talk with individuals representing a cross-section of Minnesotans, including the public and private sectors, who are familiar with state government and financial management, and are qualified to provide their insight and the benefit of their experience;
- Engage the assistance of someone from outside government with professional expertise in reorganizations within public institutions and with experience in helping workers cope with pending organizational change.

## B. Comments Solicited from Minnesotans Familiar with State Government and with Financial Management

The Treasurer was interested in obtaining a broad range of opinions and viewpoints. Consequently, a number of individuals were identified and contacted for their input. Every person contacted was enthusiastic about meeting and providing their insight and assistance. The following is a list of the experience and background of the people contacted:

- Former state government officials
- Former State Treasurers
- Current state government elected officials and appointees familiar with the operations of the Office of the State Treasurer
- Members of the banking community
- Financial service providers
- Certified Public Accountants
- Professors of the Carlson School of Management at the University of Minnesota, specializing in organizational development and strategic management
- Other business leaders

*A complete list of the individuals contacted is set forth in Appendix B.*

## C. Professional Expertise from Outside State Government

- The State Treasurer wanted an individual who had contacts with both the academic community and the large private accounting firms who could provide advice concerning financial management in a governmental context. She believed that such an individual would be a valuable and objective resource for information and for contacts with other professionals.

- Finally, she believed that she needed someone from outside of government to provide the objectivity she wanted when developing the description of the Treasurer's role within government. This was particularly true when she met with people from agencies and other entities that deal with the Office of the State Treasurer on a regular basis. She wanted someone who would challenge and critique the process, assumptions, and recommendations of others.

- She selected Bruce S. Vatne, a professional who specializes in organizational change. Mr. Vatne met separately with ten of the twenty-six people listed in Appendix B. Generally, they were the individuals who are either currently serving in government, or who very recently left government service.

*A summary of Mr. Vatne's qualifications is set forth in Appendix C.*

## III. Process Used to Collect Information and Opinion

### A. Meetings Held with Staff of the Office of the State Treasurer

Mr. Vatne met individually with all members of the State Treasurer's staff, discussed their individual roles and responsibilities, and observed their work process and procedures. Mr. Vatne wanted an objective understanding of the inner workings of the office functions and to observe firsthand how the individual jobs and responsibilities fit together.

Following meetings with the Treasurer's management staff, Mr. Vatne reviewed his understanding of the functions and made the following observations:

- The functions are distinct in nature but are interrelated and provide support, confirmation, and a "check and balance" for each other;
- These Treasurer's Office functions are unique and apparently are not performed in any other State agency;
- There are on going, process controlled, internal safeguards of the various cash management transactions. More than one set of eyes always review the transactions;
- The current operations work smoothly with very few problems;
- Current processes and procedures adhere to generally accepted accounting rules and standards and meet all statutory requirements;
- There is clear and visible tracking of all state funds and all funds are accounted for in the state's accounting system;
- The current staff members are well-trained, experienced, and work as a closely-knit team. Each member contributes significantly to the effective and efficient operation of the Treasurer's Office;
- In addition to the longevity and stability of the staff, they are cross-trained to maintain a smooth and consistent process.

The staff demonstrated high skill levels with critical functions and they take considerable pride in providing consistently high quality work every day.

### B. Meetings with People Outside the Treasurer's Office

The primary purpose of these meetings was to:

- Determine their level of understanding of Treasurer's Office operations;
- Gather opinions regarding the basic, fundamental financial functions, values, and principles that should guide the Treasurer's recommendation;
- Inquire about the relative value and necessity of separation of duties and independence.

The list of potential interviewees was reviewed and a determination was made regarding who should participate in each interview. Encouraging candor and maintaining objectivity was of paramount concern to the Treasurer. As a result, Mr. Vatne was asked to conduct several interviews on his own. In addition, Mr. Vatne participated with the Treasurer and Deputy Treasurer in several other interviews.

We sought their insight into the day-to-day functions of the Treasurer's Office, their perceptions of how the office is operating today, and their concerns or issues about current and future operations.

Discussions with the people interviewed sometimes included unsolicited opinions about possible agencies or offices where current Treasurer's Office operations could be transferred.

Specific questions discussed included:

- What safeguards are needed to ensure accurate and consistent reporting of financial information? How should that oversight be provided?

- How important is it to have "routine" internal auditing functions, either through daily, process-controlled operations or by direct intervention?

- Would a third-party, independent auditing firm from outside government add any value to the process?

- Is there a need to keep cash management functions free from political influence?

- How important are "separation" and "independence" in performing the State Treasury functions?

- Is it important for the Legislature and/or citizens to have access to the state's financial information?

In almost all cases, the people interviewed expressed a high degree of confidence and trust in the workings of the Treasurer's Office. People who deal with the Treasurer's office on a daily basis gave the staff top marks in the efficient and professional manner in which they perform their duties.

Comments from many of those interviewed indicated that our recommended plan must ensure that "nothing bad happens" and that operations continue to be performed with the same high quality, consistency, and reliability that the Treasurer's Office has always demonstrated. Based on these discussions and input, there is a clear indication from those interviewed who are familiar with the operations of the Treasurer's office, that it will be in the state's best interest to retain, intact, the functions and structure of the Treasurer's current operations. In addition, the staffing should not be changed and should remain together as a complete unit.

It was clear from these discussions that separation and independence were very important. Statements such as, "Be sure the move is to a place where there is little exposure to political influence or pressure", and "We need to avoid, at all costs, the appearance or perception of even the slightest conflict of interest", appeared frequently.

Easy and unlimited access to the state's financial condition was a major concern. Most of those interviewed indicated that such access should be "assumed" and a "given", and not depend upon some special process or procedure to ensure accessibility to appropriate information.

The comments and opinions of those interviewed have helped the Treasurer understand how various outside people and groups view the Treasurer's Office operations. These comments served as a confirmation of understanding and provided background information to help format her approach and opinions regarding the recommended plan for transferring the Treasurer's duties and responsibilities.

## IV. Functions of the Office of State Treasurer and the Treasurer's Role in State Government

- The State Treasurer's office performs several unique and distinct, but closely connected, functions on a routine and daily basis. These functions are not duplicated elsewhere in state government and are performed through the use of banking industry equipment and technology not used elsewhere in other agencies. Performance of these functions serves the purpose of:
  - settling state financial transactions each day;
  - providing daily oversight of state finances (checks and balances);
  - providing "real time" daily cash management;
  - assuring that financial controls in state government are being met day in and day out.
- These functions are accomplished through a process of verifying state expenditures, revenues and investments. What follows is a brief summary of those functions.

*Appendix D sets forth in much greater detail many of the functions described below.*

A. **Daily cash management:** This function is performed to determine how much money is available for investment each day. *See Appendix D.*

B. **Warrant processing:** The Treasurer's office, using its banking system and equipment, processes and verifies over 6 million state warrants (checks) annually and then initiates and approves the daily monetary settlement with financial institutions, including the Federal Reserve Bank of Minneapolis. *See Appendix D.*

C. **Receipt Processing:** The Treasurer's office monitors and records all monies coming into the state either directly, in the case of federal money, or through state agencies and deputy registrars. *See Appendix D.*

D. **Account balancing and verification**: This function verifies that all monies received and deposited in 150 different banks statewide and over 300 separate bank accounts by state agencies is timely, accurate, and properly recorded in the state's accounting system, MAPS (Minnesota Accounting and Procurement System). *See Appendix D.*

E. **Debt service and general obligation bonds:** The Treasurer maintains an information system for the state's debt service portfolio and maturity schedules. The State Treasurer is responsible for the issuance of payments to paying agent banks for the redemption of state general obligation bonds as well as publishing early redemption/bond call notices. *See Appendix D.*

F. **Investments**: The State Treasurer monitors and records investment transactions made by the State Board of Investment (SBI), approves the movement of money to the investing institutions, assures that all transactions are settled properly, and assures that commercial paper transactions such as repurchase agreements are adequately collateralized. *See Appendix D.*

G. **Safekeeping:** The State Treasurer is responsible for the proper disposition of property that escheats to the state, and provides a vault operation that is used for safekeeping of documents and securities on behalf of all state agencies and for cashing state warrants. *See Appendix D.*

H. **County Receipt Collections:** The Treasurer's Office receives a variety of payments from all counties. These payments represent fines, fees and surcharges collected by court administrators and county offices. *See Appendix D.*

I. **State Treasurer is a Financial Representative of the State of Minnesota:** An important role of the State Treasurer is to act as Minnesota's representative in policy discussions with the federal government. These discussions relate to such matters as negotiations concerning federal funds transfers to the state and federal taxation of interest on state debt obligations.

The State Treasurer also represents the state as a member of various national organizations that attempt to influence federal government policies affecting state governments and pension beneficiaries. These organizations include the Council of State Governments (CSG), the National Association of State Treasurers (NAST), the Council of Institutional Investors (CII), and the National Association of Auditors, Comptrollers and Treasurers (NASACT).

## V. Sound Financial Management Principles for Government: Government vs. Private Business

The principles of sound financial management are the same whether applied to state government or to a private business. With respect to cash management those principles are simple:

**Separation of duties;**
**Independence**

Differences exist only in how government and private business tend to achieve these principles. **Government uses independently elected officials; private business uses independent, external audits.**

### A. Accountability vs. Efficiency

An important element of this analysis is that government is required to provide **public accountability**, whereas the private sector is driven by **operational efficiency and profitability**. The differences are not surprising.

- Elected officials are judged primarily by how well they safeguard the public trust.
- A Chief Executive Officer (CEO) of a private business is judged primarily by the profits the business generates.

The only question is whether one approach is preferable to the other, and the answer is "No". Each serves the purposes for which they are designed and both accomplish the goal of remaining consistent with the principles of **separation and independence.**

Government has typically adhered to these principles by using a system of checks and balances; that is, by investing powers that need to be kept separate and independent in individuals who are elected separately. For example:

- 42 of the 50 states maintain the "treasury function" in an agency separate from any other state agency associated with state government accounting activities;
- 2 of the remaining 8 states maintain the "treasury function" in an agency headed by a statewide elected official other than the Governor.

  *A detailed listing is set forth in Appendix E.*

Private industry takes a more vertical approach that gives the CEO more control but preserves the same basic principles:

- The cash manager and the controller may both report to the same person, such as a Chief Financial Officer. However, separation and independence is preserved by using a combination of several internal control devices, requiring:
  - the Internal Auditor, who reports directly to the Board or a subcommittee thereof, to monitor the company's financial management practices;
  - periodic audits by independent third party CPA firms who present their findings to the Board or a subcommittee thereof;
  - the cash manager to provide periodic informational reports directly to the Board of Directors, or a subcommittee of the Board, regarding the company's cash position.

- Private businesses also typically have other built-in means of insuring the integrity of the system, such as lenders who can demand external audits and who frequently also function as the business' bank.

Not surprisingly, government is concerned about public accountability and private business is concerned about internal efficiency. Both however end up at the same place; that is, **the short-term cash management system is kept separate and independent from other accounting activities.**

### B. In government, institutional solutions are more likely to endure than solutions that can be modified to satisfy financial and political constraints

Other differences between government and private business are noted. Government does not have a CEO in the same sense as does private business. A CEO, usually with the cooperation of a friendly Board of Directors, has a high degree of control over the policies and business practices of the company. In government, this control is dispersed to a much greater degree. A democratic government is designed to allow the public to have greater access to and impact upon its policies. The executive function of state government is purposely distributed among several constitutional officers, thereby creating a built-in separation of duties and independent accountability to the voters.

For all of these reasons, government seeks to find ways to "institutionalize" its core functions to make them less susceptible to the inevitable pressures of the political process. Government is a **system of laws enacted by an elected legislature** rather than a **set of policies** that are established from time to time by an individual CEO. Laws are more difficult to change than policies, and the public prefers it that way; changes can only be made after a process is followed that includes many policymakers representing the general public.

Government is inclined to establish a system of checks and balances whenever possible to accomplish its need to be accountable and to protect the public from arbitrary and capricious actions taken in response to short-term problems. Much of government operates on the basis of policies that change from one administration to the next. However, for functions that are central to its basic operations, traditionally it has preferred to develop solutions that are most likely to endure through political changes, good as well as hard times.

**The basic principle is: In government, find a solution consistent with a system of checks and balances; provided the risk you want to protect justifies any loss of efficiency.**

## VI. Conclusions

### A. How Important is the State's Cash Management Operation to the State's Financial Management System?

The best reflection of how people answered that question is to include some of their thoughts:

- Always use two sets of eyes in financial transactions;
- Never have the same person who issues the checks be the one who does the accounting;
- Never allow one person to handle the entire transaction from beginning to end;
- Keep cash receipts separate from the accounting function;
- Avoid perceptions of conflict of interest;
- Be sure there is a system of internal controls;
- Be careful of "electronic" commerce: there is much greater chance for fraud, for bank errors caused by system "failures", and for not understanding the underlying transaction;
- Surprised that state government is not regularly audited by an independent, private accounting firm as is customary in private business;

- The system must have built in "firewalls" that take into consideration the "degree of opportunity for mischief" and the "magnitude of the exposure";
- An annual risk assessment and security review should be performed on all electronic systems to ensure that firewalls have not been breached.

There were many similar comments and observations. **Suffice to say that the functions performed by the State Treasurer are necessary and are not performed elsewhere in government.**

## B. Possible Recommendations That were Suggested

It was surprising that there were so many different thoughts about which agency or constitutional office (and combinations thereof) should receive the duties of the State Treasurer. The following list reflects people's opinions, prior studies, and practices in other states for conducting the treasurer's and cash management functions of state government.

- An existing Council or Board would appoint a State Treasurer; for example:
    - State Board of Investment (Governor, Auditor, Secretary of State, and Attorney General); or
    - Executive Council (Governor, Lieutenant Governor, Auditor, Secretary of State, and Attorney General)
- Governor would appoint a State Treasurer
- Legislature would elect a State Treasurer
- Another Constitutional Officer
- Legislative Auditor
- Commissioner of Finance
- Commissioner of Administration
- Commissioner of Revenue
- Treasurer's duties would be performed within the Executive Branch as directed by the Governor, but the Treasurer would report annually to a special legislative joint committee.

## C. State Treasurer's Analysis

The current State Treasurer has been associated with the Office of the State Treasurer for over 12 years, and has served as State Treasurer since January, 1999. She is very familiar with the inner workings of the office as well as with the other agencies of government that interact with the State Treasurer. She is also knowledgeable about the debate within the legislature that preceded its decision to place the question of abolishing the office on the ballot. Finally, she has had the benefit of discussing the issue of transferring the duties with some of the most informed people in Minnesota. Taking all of the above into consideration the State Treasurer concludes as follows:

- The people of Minnesota decided, by a close vote, to abolish the elective office of State Treasurer. She believes it will not be consistent with the voters' wishes to merely substitute an "appointed" Treasurer for an elected Treasurer. Therefore, she believes that the **duties should be transferred to an existing governmental entity**.

- **She believes that the people of Minnesota, by their vote, did not intend that the state's financial system should in any way be compromised in order to reduce the size of government**. She assumes that the voters felt that there should be a way for the State Treasurer's duties to be fully performed within the government, and with all necessary safeguards, without having a separate constitutional office for that sole purpose.

- **The duties performed by the State Treasurer are unique** and are not performed by any other agency of government, nor are they duplicated in any way. Current technology allows business processes to be conducted in separate physical locations without compromising the ability of these business processes to be closely integrated for purposes of efficiency. Indeed, the current integration of processes between the Department of Finance, the Department of Revenue, the State Board of Investment and the Office of the State Treasurer is an excellent example of such integration and efficiency. Therefore, **physical or organizational proximity should not be a significant consideration when evaluating options**.

- **The financial management system of state government belongs in the executive branch of government**. There are four states where the legislature elects the state treasurer, but the Treasurer does not believe that this is a good model because it creates constitutional issues in Minnesota concerning the "separation of powers" between the executive and legislative branches. This model is also confusing as to which branch is truly accountable for this governmental operation.

- **The importance of checks and balances within government cannot be over-emphasized**. The phrase "checks and balances" itself has become almost synonymous with what a democratic government provides to its citizens as a safeguard against abuse of the public trust. The Treasurer believes that her recommendation should be consistent with this approach, unless there are other significant advantages in efficiency by taking a different approach. The perception of safety, accountability, separation, and independence cannot be ignored.

- Given the above conclusions, **the first consideration was whether the duties should be transferred to an agency controlled by the Governor, or to another constitutional officer(s)**. The most often-mentioned agency is the Department of Finance. On its face, Finance seems an obvious choice. Indeed, the working relationship between Finance and the Treasurer's office is very close and has been a cooperative and healthy relationship over many years.

Such a recommendation would be consistent with what is frequently, but not always, done in private businesses. A private company has a Chief Financial Officer (CFO) whose duties include the Treasurer and Cash Management function, as well as the accounting function. However, as noted earlier, for this proximity of duties to be successful over the long run it is necessary to establish "firewalls" between these two functions that ensure permanent separation and independence. Private businesses have a number of tools at their disposal to make certain these firewalls don't collapse: internal auditors, independent external auditors, lenders requiring their own audits, a CEO who can act quickly if a problem is suspected, etc. Government does not typically have the same controls.

Having pointed out these problems, there remains the fact that transferring the duties to the Commissioner of Finance is workable. Firewalls can be constructed that would meet all requirements of good governmental financial management. Indeed, all of the possible choices referred to earlier can be made to work and can pass muster for purposes of satisfying accounting standards.

The question remains as to which choice is the best choice. The conventional wisdom is that transferring the duties to the Commissioner of Finance would be the most efficient use of the government's resources. The Treasurer does not agree. The close relationship between Finance and the Treasurer actually argues against these efficiencies:

- Technology provides the capability of sharing information seamlessly and quickly; at the same time, control of the data can be organized in such a way that separation and independence are maintained.
- The Department of Finance itself estimated that the cost savings of abolishing the State Treasurer was limited to the salaries of the Treasurer and the Deputy Treasurer. All of the duties and the people who perform them would have to be continued regardless of what agency or office receives them.
- The fact that the relationship is as close as it is suggests that it is not advisable to reduce all barriers by putting both functions within the same agency.
- If the duties were transferred to the Department of Finance, the Treasurer believes additional on-going measures (with additional costs) would have to be taken to ensure continued separation and independence of function between cash management and accounting. In private business this is

typically done by maintaining an internal auditor (separate and distinct from the external auditor) who has direct access to the Board of Directors or a subcommittee thereof; in government this would be the Legislature. The Treasurer believes that providing similar safeguards in a government setting is costly and unnecessary.

- **The Treasurer believes that, on balance, transferring the duties to a constitutional officer in the executive branch is the best solution. That Constitutional Officer should be the State Auditor**. This recommendation most closely mirrors the model that Minnesota and most states have followed without problems for over a century. It costs no more, has built-in accountability, and maintains separation and independence from the accounting function.

## VII. Recommendation

The Treasurer recommends that upon the completion of her term as State Treasurer:

- All duties, responsibilities, and authority of the State Treasurer should be transferred to the State Auditor.
- All staff and appropriated funds should be transferred to the State Auditor.

An annual risk assessment of the cash management electronic processing systems should be conducted to ensure that they are secure for purposes of safely transferring large amounts of money to and from the state's bank accounts. This condition is recommended without regard to which constitutional officer or agency the Treasurer's duties are transferred.

## VIII. Additional Recommendation regarding the State Board of Investment

The Treasurer also notes that upon the completion of her term the State Board of Investment (SBI) will consist of four members instead of the current five. Therefore, in order for the SBI to change any of its policies beginning in 2003 and thereafter, it will be necessary to convince three out of four members to do so instead of three out of five, a much higher threshold indeed. The Treasurer believes that over the course of many years the state and the beneficiaries of the invested pension funds would be better served if that threshold were not so difficult.

The Treasurer urges the legislature to examine ways to remedy this unfortunate situation. Over the last 141 years since statehood the state and its public employees have been served extremely well by the SBI. All five members of the SBI have been elected statewide. The Treasurer believes it is best to retain the same historical composition to the extent possible. The best choice would be the

Speaker of the House of Representatives, an individual elected by the largest group of elected representatives within the state.

## IX. Comments from the Honorable Mary Kiffmeyer, Secretary of State

State Treasurer Johnson and her staff are to be commended for the detail and thoroughness of the *Study and Recommendations for Transferring the Powers, Duties and Responsibilities of the State Treasurer*. The Report is both meticulous and complete in its review of the many issues that arise out of the electorate's 1998 vote to abolish the Office of State Treasurer.

With that said, I disagree with both of the policy recommendations offered by Treasurer Johnson; namely that:

> (1) the powers, duties, responsibilities, appropriations, personnel and equipment of the Office of the State Treasurer be transferred to the Office of the State Auditor; and
>
> (2) the Speaker of the Minnesota House of Representatives should replace the State Treasurer on a five-member State Board of Investment.

In my view, the facts, analyses and policy goals that are referenced in the Report point to other and different conclusions. Respectfully, therefore, I dissent from these recommendations.

### I. <u>Secretary Kiffmeyer's Comments to the Treasurer's Factual Analysis</u>:

Treasurer Johnson is entirely correct when she notes that "separation of the cash management function from the accounting function has been a hallmark of [Minnesota] state government's financial system since statehood," and that an important policy objective is to assure that the "short-term cash management system is kept separate and independent from other accounting activities in government." <u>See</u> Report at 9-10 and 19-20. Similarly, Treasurer Johnson is correct when she states further that:

> (a) the duties of the Treasurer should be transferred to an existing governmental entity;
>
> (b) the 1998 vote to abolish the Office of Treasurer should not be construed as an effort to compromise the state's cash management system;
>
> (c) current technology would permit the Treasurer's duties to be performed from a location that is remote from the other agencies with whom the Office of Treasurer interacts;

(d) the financial management system of the state belongs within the executive branch; and

(e) the safety of state funds, the accountability of those undertaking financial transactions and the independence of these same managers from bureaucratic or political pressures, are important public purposes.

See Report at 21-22. These facts, however, lead me to different policy conclusions than those set forth by the Treasurer.

II. Where in State Government Should We Place the Functions and Resources of the State Treasurer?

a. Treasurer Johnson's Proposal for Transfer of the Official Functions and Resources of the State Treasurer to the State Auditor:

While agreeing with Treasurer Johnson that transfer of her duties to the State Auditor is a reasonable response to the vote to abolish the Office of State Treasurer, it is not, in my judgment, the *best* possible response.

In my view, the argument that such a transfer to the State Auditor "most closely mirrors the model that Minnesota and most states have followed for over a century," see Report at 23-24, is not very compelling. In accomplishing this transfer there are other, more important values than "mirroring" past practices.

Likewise too, it is not at all clear that the State Auditor or her staff bring any special expertise to the work of maintaining and monitoring state cash accounts. Compare Report at 9. While, as the Treasurer observes herself, the State Auditor has performed some state accounting functions in the past, the *cash management functions* performed by the State Treasurer have never been a part of the State Auditor's responsibilities. See Report at 9-10.

Finally, the arguments that the Treasurer's functions should be transferred to the Office of the State Auditor because it "costs no more, has built-in accountability, and maintains separation and independence from the accounting functions," are likewise unpersuasive. These arguments could, with equal force, form the basis of transferring the Treasurer's functions to either the Office of the Attorney General or the Office of the Secretary of State – items that are not recommended.

b. Secretary Kiffmeyer's Proposal Transfer for Resources of Official Functions and Resources of the State Treasurer to the State Board of Investment:

For me, the question of where in state government to place the duties that are now performed by the State Treasurer, pivots on the question of which department is best equipped to undertake important and complex cash management functions. In my judgment, the duties, responsibilities and resources of the State Treasurer should be transferred to the State Board of Investment. The Board's Executive Director and staff have a wide range of experience in tracking and managing multi-billion dollar accounts for the State of Minnesota; are directly accountable to a Board that consists of popularly elected state-wide office holders; and are separate and independent from the accounting functions undertaken by the Department of Finance. The State Board of Investment blends the experience, accountability and independence that are sought by the State Treasurer in her Report. Among the many possible alternatives that are outlined by Treasurer Johnson (see Report at 21), transfer of Treasurer functions to the State Board of Investment is the best policy choice.

III. Should the Law be Changed so as to Continue the Practice of Having Five Members of the State Board of Investment Following the Abolition of the Office of State Treasurer?

While agreeing with the Treasurer Johnson that the State of Minnesota and its pensioners are best served by a five-member State Board of Investment, I do not share her view that the Speaker of the Minnesota House of Representatives should be appointed to the Board seat that is vacated by the State Treasurer. See Report at 24-25.

a. Secretary Kiffmeyer's Comments to the Treasurer's Proposal to Appoint the Speaker of the Minnesota House of Representatives as a Fifth Member of the State Board of Investment.

As the Treasurer points out in her report, each of the Members of the State Board of Investment are elected by statewide constituencies – an important protection that should not lightly be abandoned in favor of any other Board Member.

The fact that the Speaker of the House is "elected by the largest group of elected representatives in the state" is not a similar protection. Further, under the Treasurer's proposal, it is conceivable that the residents of one-half of one state legislative district (those of the Speaker's home district) would have disproportionate influence on the decision-making of the Board when compared to other Minnesotans. Such a result is not desirable.

b. Secretary Kiffmeyer's Alternative Proposal to Authorize the Four Elected Members of the Board to Appoint a Nominee of the Various State Pension Systems as a Fifth Member of the State Board of Investment.

If a five-member State Board of Investment is desirable, and in my view it is, a better proposal would be to permit the four elected Members of the Board, to, by a majority vote, select a nominee of the various pension systems to serve as a fifth member of the State Board of Investment. Under such a system, this Board Member would directly represent the interests of state pensioners whose retirement funds the Board holds in trust. Again, unlike the proposal of appointing the Speaker of the Minnesota House of Representatives to the Board, those making the selection of the fifth Board Member (namely, the Constitutional Officers) are directly accountable to each and every voter in the State of Minnesota.

It bears repeating, however, that the majority requirements are precisely the same – 3 votes – whether the Board consists of 4 members or 5 members; the only difference is the number of possible combinations of Board Members that could constitute a 3-vote majority. In my view, it would be better to leave the Board at 4 Members following abolition of the Office of the State Treasurer than to appoint a Member whose selection was accountable only to some, but not all voters in the State of Minnesota.

IV. Succession to the Chairmanship of the State Board of Investment Administrative Committee Should be Accounted for in Any Final Transition Plan.

While it is not a matter of Legislative concern, some care should be given to deciding who should serve as the Chairman of the State Board of Investment Administrative Committee following the abolition of the Office of State Treasurer. By Board tradition, the State Treasurer chairs this Committee. In my view, the best alternative would be to have the Chairmanship of the State Board of Investment Administrative Committee rotate, on an annual basis, among the elected Board Members.

Conclusion:

While I disagree with both of the policy recommendations offered by Treasurer Johnson, I commend both her and her staff for a detailed, thorough and complete Report on Transferring the Powers, Duties and Responsibilities of the State Treasurer. In my view, the Treasurer's functions should be combined with the duties of the State Board of Investment and that a fifth member, if any, of the State Board of Investment should be selected by, or accountable to, each and every voter in Minnesota. Likewise, the Chairmanship of the State Board of Investment Administrative Committee

## VI. Comments from the Honorable Pam Wheelock, Commissioner of Finance

History

The Department of Finance was created in 1973 to consolidate and modernize the financial management functions of state government. The department consolidated functions from the State Auditor's Office, the Department of Administration, and the Public Examiners Office. By statute, the Commissioner is the state's controller and chief accounting and financial officer, and is responsible for the State's accounting, payroll, financial reporting, budgeting, forecasting, and debt management functions.

In 1985, the Minnesota Legislature transferred the duties of the State Treasurer to the Department of Finance. The only duty that remained in the Treasurer's office was the maintenance of the state bond fund, due to a constitutional requirement. On July 1, 1985, the Department of Finance established the Cash and Debt Management Division to include the Treasurer's operations. Most employees of the State Treasurer's Office transferred to the Department of Finance; no new positions were created. The offices remained in the State Administration Building. The Cash and Debt Management Division reported directly to the Commissioner, as did a separate division responsible for Accounting Services. This organizational structure, with cash management and accounting services in separate divisions, but reporting to the chief financial officer, is common in both private industry and other governmental units.

The State Treasurer sued on the grounds that the Legislature could not make this transfer of duties from a constitutional office. The State Treasurer won the lawsuit in 1986 when the Supreme Court ruled the Legislative action unconstitutional. The duties of the State Treasurer were returned to him when the new State Treasurer took office in January 1987.

During the one and a half years the Department of Finance performed the Treasurer's functions, the state's financial integrity was maintained, and significant changes were made to cash management practices. The Office of the Legislative Auditor raised no audit findings concerning cash management during these years. Cash management practices were improved when the Department partnered with private sector companies in a STEP project, with the main goal of reducing the time between receipt of payments and deposit in the state's bank account. As a result, significant changes were made in the processing of checks and bank deposits. These improvements for handling cash were left in place when the duties returned to the Treasurer's office in 1987.

Analysis

Contrary to the implications in the Treasurer's report, there is no inherent reason why the functions currently located in the Treasurer's office must be located in a separate constitutional office. While the report suggests that independence, accountability, and separation of duties (checks and balances) would be compromised if the functions were not located in a separate constitutional office, there is considerable evidence to the contrary.

Accountability and independent scrutiny of financial functions would be maintained with the addition of the cash management functions to an existing state agency. The cash manager's performance would be subject to regular review and poor performance could result in replacement at any time, not delayed until the next election. All large state agencies are subject to independent audit scrutiny annually by the Office of the Legislative Auditors. Furthermore, many state agencies, including the Departments of Administration, Finance, and Revenue, have internal audit units which could do additional audit work if necessary. As these audits are already routine, there would be no additional cost.

Maintaining adequate separation of duties between the cash management and accounting functions could be accomplished within the Department of Finance without additional cost. As was done during the 1985/86 period, the cash management functions would be organizationally located under a separate Assistant Commissioner from the accounting functions. The expertise in dealing with cash management functions is already in place and internal controls to assure separation of duties would be established to achieve the desired results.

It is clear from examination of other governmental and private entities that the organizational model of one chief financial officer, responsible for both the cash management and accounting functions, can operate efficiently without jeopardizing the financial integrity of the organization. Throughout local government, in several states, and at the federal level, in addition to private industry, this model is common and functions without compromising accountability or efficiency. Georgia, New Jersey, Montana, Texas and New York have the treasury and Controller duties combined in one department. Florida has voted to merge the offices of controller and treasurer into one chief financial officer (effective 2002.) Other states are looking at combining the treasury functions with another department. This model would not be so prevalent in organizations of all sizes if it presented a risk to financial operations.

The primary duty of the state auditor is to help ensure financial integrity, accountability, and cost-effectiveness of Minnesota's local governmental entities. The state auditor has not had responsibility for the State of Minnesota's financial operations since the creation of the Department of Finance in 1973. Similarly, the Secretary of State has duties quite removed from the treasurer's responsibilities. The main functions of that office are various business filings, UCC recordings, and serving as the chief election official. The capacity and expertise to take on the Treasury functions are not consistent with the purpose of these constitutional offices. In both cases, their ability to concentrate on their primary functions would be diluted with the addition of the Treasurer's duties.

If there are efficiencies to be gained with the elimination of the separate Treasurer's office, they are most likely to be achieved with placement of those functions in the Department of Finance. The Department's existing expertise in state government finance, including cash management experience, will permit a smooth transition of the Treasurer's functions without additional costs. Combining these duties within the department where many closely related functions are already in operation will provide the best opportunity for realizing any efficiencies. While the necessary separation of the cash management and accounting functions means any efficiencies are likely to be minimal, they are certainly more likely achieved at the Department of Finance than by building the financial expertise in another agency or separate constitutional office.

## Conclusion

Within the executive branch, the Department of Finance is the obvious location for the state's cash management as well as accounting responsibilities. The Treasurer's functions are consistent with the Department's mission of ensuring the integrity of the state's fiscal resources. The people of Minnesota will be best served by placing the Treasurer's duties with the chief financial officer of the state, the Commissioner of Finance.

## State Board of Investments Membership

With the elimination of the treasurer's office, the board of investments will be reduced to four members. Historically, the state has been well served by a five-member board of constitutional officers. The Treasurer's seat should be replaced with the Lieutenant Governor, the only remaining constitutional officer not already on the board.

# APPENDICES

# Appendix A

## Past Studies to Reorganize the Executive Branch of State Government

The full text of the Reports listed below are available at the
Legislative Reference Library
(citations provided)

| Date | Report | Recommendations | Leg. Ref. Lib. No. |
|---|---|---|---|
| 1948 | Report of the Constitutional Commission of Minnesota | **Removes Secretary of State and State Treasurer from the Constitution.** "It would be for the legislature to determine whether these offices would be continued, elective or appointive." | KFM 5801 1857 .A183 |
| 1950 | Little Hoover Commission | Reduce number of elective offices in executive branch; reduce 105 state agencies to 17 major departments, with administrative authority centered in Governor. **Assigns duties of State Treasurer and State Auditor to the Department of Administration.** | JK 6138 1950 .A5 |
| 1955 | Governmental Reorganization (Gov. Freeman's Message to the Legislature) | **Retains the State Treasurer** | J 87 .M62 1955 |
| 1955-56 | Minnesota Self-Survey | **Abolishes the Offices of Attorney General, Secretary of State, State Auditor and State Treasurer.** All offices would be gubernatorial appointments, with the exception of the State Auditor, which would have "all its functions reassigned." | JK 6136 .M68 A3 |
| 1968 | Report to the Governor's Council on Executive Reorganization by the Public Administration Service | **"...elimination of the constitutional-elective offices of the Auditor, Treasurer and Secretary of State is strongly indicated."** State Treasurer's duties brought into "organizational alignment with the Department of Administration." | JK 6131 .W6 |
| 1993 | CORE Project Report: Reorganizing the Executive Branch (Commission on Reform and Efficiency) | Establishes a Secretary of Finance, which would include the Departments of Finance and Revenue, and the Office of Strategic and Long Range Planning. **Does not abolish the State Treasurer. Recommends "examin(ing) the roles and relationship between the Finance Secretary and the State Treasurer.** | JK 6136 .C68 1993 |

# Appendix B

## List of People Interviewed

**Dr. Avner Ben-Ner, Ph.D., Director**
Industrial Relations Center
Department of Human Resources and Industrial Relations
Carlson School of Management
University of Minnesota

**David Bergstrom, Executive Director**
Minnesota State Retirement System

**Howard Bicker, Executive Director**
Minnesota State Board of Investment

**James Campbell, Chairman & Chief Executive Officer**
Norwest Bank Minnesota, NA

**Arne Carlson, Chairman & CEO**
American Express Funds
Former Minnesota Governor
Former Minnesota State Auditor

**The Honorable Judith H. Dutcher**
State Auditor

**Cecile Ferkul, Audit Director**
Office of the Minnesota Legislative Auditor

**Douglas Gorance, Director**
Chief Investment Officer
University of Minnesota Foundation
Member, Investment Advisory Council, State Board of Investment

**Rosalie Greeman, Associate Vice Chancellor for Accounting**
Minnesota State Colleges and Universities
Former Assistant Commissioner of Accounting, Minnesota Department of Finance

**Joan Anderson Growe**
Former Minnesota Secretary of State

**Claudia Gudvangen, Audit Manager**
Office of the Minnesota Legislative Auditor

**Dennis Jensen, Manager**
Finance and Systems Accounting Division
Minnesota State Retirement System

**Jay Kiedrowski, Executive Vice President**
Norwest Bank Minnesota, NA
Former Commissioner, Minnesota Department of Finance

**Laura King, Vice Chancellor/Chief Operating Officer**
Minnesota State Colleges and Universities
Former Commissioner, Minnesota Department of Finance

**Steven W. Laible, C.P.A., Partner**
Public Services Division
KPMG, LLP

**James Lord, Esq.**
Miles Lord and Associates
Former Minnesota State Treasurer

**Dr. Alfred Marcus, Ph.D., Department Chair**
Strategic Management and Organization
Carlson School of Management
University of Minnesota

**Judith Mares, President**
Mares Financial Counseling, Inc.
Member, Investment Advisory Council, State Board of Investment

**Michael A. McGrath**
Former Minnesota State Treasurer

**James Nobles, Legislative Auditor**
Office of the Minnesota Legislative Auditor

**Gary Norstrem, Member**
Investment Advisory Council, State Board of Investment
Former Treasurer, City of St. Paul, Minnesota

**Daniel Osborn, Audit Director**
Norwest Audit Services, Inc.
Norwest Bank Minnesota, NA

**Mansco Perry, Portfolio Manager**
Minnesota State Board of Investment

**Richard Pfutzenreuter, Associate Vice President and Chief Financial Officer**
Office of Budget and Finance
University of Minnesota

**Wayne Simoneau, Acting Commissioner**
Minnesota Department of Employee Relations
Former Commissioner, Minnesota Department of Finance

**Thomas Triplett, President**
College of Visual Arts, St. Paul, Minnesota
Former Commissioner, Minnesota Department of Finance

**Elaine V. Voss**
Former Minnesota Deputy Secretary of State

**William Wilkening, President/Director**
Citizens Independent Bank
Former President, Minnesota Bankers Association

**Jan Yeomans, Treasurer**
3M Company
Member, Investment Advisory Council, State Board of Investment

## Appendix C

## Bruce S. Vatne
## Summary of Qualifications

Bruce S. Vatne has been providing effective management consulting services for more than 25 years. He has worked with a wide variety of industries including manufacturing, distribution, health care, higher education, and retail, with companies ranging from $20 million in sales to the Fortune 100. Recent clients have included Horton, Inc., Minneapolis Public Schools, Honeywell, the University of Minnesota, United Hardware, Polar Manufacturing, and Liberty Carton Co.

In his own business and as the Director of Resource Productivity at Coopers & Lybrand (now PricewaterhouseCoopers), Mr. Vatne managed large engagements to implement Business Process Redesign, Re-organization, Just-In-Time methods, Total Quality Management (TQM), and Cost & Inventory Management techniques. He also specializes in the application of Reengineering, Business Process Redesign, TQM, and productivity methods to administrative areas and has conducted assessments, planning sessions, seminars, and project management to support these implementation efforts.

Mr. Vatne identifies with the specific business issue(s) at hand, and during the implementation, gains the confidence and trust of both management and the staff. He is a strong partner and provides the needed skills in assisting organizations achieve their operating and management goals.

Examples of projects completed by Mr. Vatne:

- Directed over twelve engagements with a Big Ten university to assist various schools and colleges in developing in-house business process redesign capabilities. The process assessed current capabilities, analyzed and revised processes, eliminated redundant or unnecessary operations, and streamlined processes and procedures

- Worked over a three year period with a major Class I railroad to reduce costs, improve operational efficiency and effectiveness, and provide organizational alternatives. Implemented Process Redesign systems for Payroll, General Accounting, Freight and Customer Accounting, and the entire Disbursements function and produced improvements ranging from 25-40% and approximately $15 million in annual savings.

- Directed a 16-week engagement with a $150 million manufacturer of energy controls. Managed and trained a team of 12 client personnel in the Just-In-Time methodology. Conducted a detailed review of all operations and support functions, developed a new manufacturing design, and prepared a detailed implementation plan with an expense and payback timetable. The team identified $14 million in potential savings opportunities.

## Appendix D

## Detailed Description of the Core Functions of the Office of the State Treasurer

### Daily Cash Management

Throughout each day, through a variety of methods including continual interaction with banks and agencies, the staff monitors and determines:

- the amount of funds that will be available in the state treasury each day;
- the payments leaving the state treasury.

This process allows the Treasurer to determine two to three times a day the amount of funds that are available for investment. This information is certified to the State Board of Investment (SBI) at least twice a day at approximately 7:30 A.M. and 11:30 A.M. An additional investment is made in early afternoon if additional funds become available.

The ability to determine earlier rather than later each day the maximum amount of funds available enables the State Board of Investment to enter into agreements with investment firms and brokers earlier in the day when interest rates and terms are most favorable.

### Warrant Processing

The State Treasurer's banking system maintains certain information related to each and every warrant (check) issued by agencies.

- Agencies issuing warrants include the Department of Finance, Department of Revenue, Department of Human Services and a number of Legislative entities.
- As the warrants are cleared through our financial institutions they are delivered to the State Treasurer by the banks every business day requesting final settlement.
- These warrants, approximately 6 million annually, are processed through the treasurer's banking system as they are presented each day.
- The Treasurer's system and staff verify the validity of each warrant to confirm settlement amounts, to protect against fraud including forgeries and illegally produced duplicates, and to capture and return warrants for which payment has been stopped by the issuing agency.
- The warrant process also verifies the controls used by agencies issuing warrants to avoid duplicate warrants being issued and processed.

The Office of the State Treasurer verifies that agencies follow approved accounting procedures and that internal controls for issuing warrants are in place.

This part of the process checks to make sure that the issued warrants have been reported to the state financial reporting system (MAPS) and that the agency has not forgotten to enter the required financial information.

In effect, the warrant processing system provides on-going, **daily oversight** of the accuracy of state government's warrant system.

**Receipt Processing**

The State Treasurer's Receipt Processing system ensures that all monies coming into the State Treasury have been accounted for.

- Money being deposited includes federal dollars, state revenues, agency funds, maturing investments, earnings from banks, county receipts, etc.
- All money that the State receives is deposited in a bank account managed by the State Treasurer, and the State Treasurer's office verifies that the funds have been entered into MAPS.
- The process keeps track of all dollars, records each receipt for each agency, verifies the amounts, and identifies errors.
- These account balances are used to determine the amount of money the state has that can be invested after all outstanding warrants have been paid.

The office monitors the management of the deposits in "real time" and does that every day. In the event an agency anticipates a significant deposit (for example, federal funds transfers, tobacco settlement money, etc), the Treasurer's office will work with the agency to determine the most effective method of deposit to take full advantage of prevailing interest rates.

Only the State Treasurer has the authority to withdraw funds from the accounts. This separate authority is integral to keeping the cash management function separate from the accounting function of state government.

**Account Balancing and Verification**

Account balancing and verification is performed on a daily basis to make certain that all state deposit accounts are in balance and that all funds that went to the bank were reported accurately to the state's accounting system (MAPS).

- Over 300 checking accounts are reviewed and balanced monthly.
- Accounts are "swept" daily. This means that all of the money that has been deposited into over 300 state bank accounts throughout the state is electronically transferred every business day into one general account where it is aggregated for investment.
- Account balancing verifies that all money received by the state has been deposited into the state's bank accounts and verifies that all money has also been properly entered in MAPS.

- Account balancing guarantees that the bank balance is correct and in accordance with what has been deposited.
- This process identifies mistakes made by the bank and ensures that the appropriate correction is made. These can include returned items, missing items, mathematical errors, keying errors, etc. The office acts as a liaison between state government and the banks to ensure that appropriate measures are taken to prevent and correct errors.
- Finally, the State Treasurer makes certain:
    - that agencies are making deposits in a timely and efficient manner to capitalize on the state's ability to invest and maximize earnings on its cash on hand;
    - that every dollar in MAPS has gone through the accounting system and can be converted to cash.

**Debt Service and General Obligation Bonds**

The State Treasurer monitors the state's debt service obligations on a daily basis to determine the amounts due each day to make principal and interest payments to holders of the state's outstanding bonds. The State Treasurer

- maintains a portfolio of all state bond issues and amortization schedules for each issue;
- makes the principle and interest payments to lending institutions in accordance with schedules determined at the time the bonds are issued;
- publishes "call dates" to identify the exact date when State bonds are being called for early redemption, typically to take advantage of more favorable interest rates;
- monitors all "unclaimed" bonds and reconciles with the paying agency or institution, including the identification of the bonds and making certain they are either redeemed or returned to the state;
- ensures that Debt Service payments are made on time so the state does not incur any penalties; and
- allocates all principal and interest payments to the budgets of the agencies responsible for repayment of the debt obligation.

**Investments**

The staff of the State Board of Investment (SBI) enters into various investment transactions each day. All relevant information about those investments, including broker information, maturity dates, interest rates, and the dollar amounts invested are forwarded to the State Treasurer where it is entered into the Treasurer's banking information system.

The State Treasurer uses this information to complete the circle of verifying that the state's cash on hand has been invested as requested and is aware when the investment will mature, which affects future cash management decisions. The State Treasurer:

- approves the movement of state funds from the state's bank accounts to brokers;
- maintains a record of all transactions to resolve discrepancies;
- verifies each and every investment transaction upon maturity to ensure that the state received the correct amount of principal and interest;
- provides the Department of Finance with information necessary to update the state's accounting system (MAPS);
- daily monitors collateral, which is pledged by brokers to guarantee repurchase agreements entered into by the SBI, to make certain it is sufficient to protect the state against loss;
- use the information each day for cash management purposes.

**Safekeeping**

The State Treasurer:

- receives and maintains records of property that has escheated to the state;
- maintains a vault facility
  - to hold in a secure environment valuable documents and securities for state agencies;
  - to provide facilities for the purpose of cashing state warrants.

**County Receipt Collections**

A variety of Minnesota statutes require that all counties throughout the state collect various fees, fines and surcharges through the court systems as well as local county offices. These monies are forwarded to the State Treasurer where they are recorded by county and purpose, then deposited into a State Treasurer's bank account and subsequently entered into the state's accounting system (MAPS). These funds are credited to the general fund or to dedicated funds, as prescribed by law.

# Appendix E

## State Treasurers in the United States
## How are they Elected/Appointed?

- 36 – Elected by the people and function as separate agencies

- 3 – Appointed by the Governor and function as separate agencies. All serve at the discretion of the Governor (Michigan, New Jersey and Virginia)

- 3 – Appointed by the Governor and function within other agencies

  - Alaska – Treasurer is the Deputy Commissioner of the Department of Revenue; serves at the discretion of the Governor.
  - Hawaii – Treasurer is the Director of Finance within the Department of Budget and Finance; serves at the discretion of the Governor.
  - Montana – Treasurer functions within the Department of Administration; 4 year term.

- 1 – Appointed by the State Depository Board, of which the Governor is chair. Treasurer functions as a separate agency and serves at the discretion of the board (Georgia).

- 1 – Appointed by the Commissioner of Taxation and Finance and serves at the discretion of the commissioner. Treasurer is the Deputy Commissioner (New York).

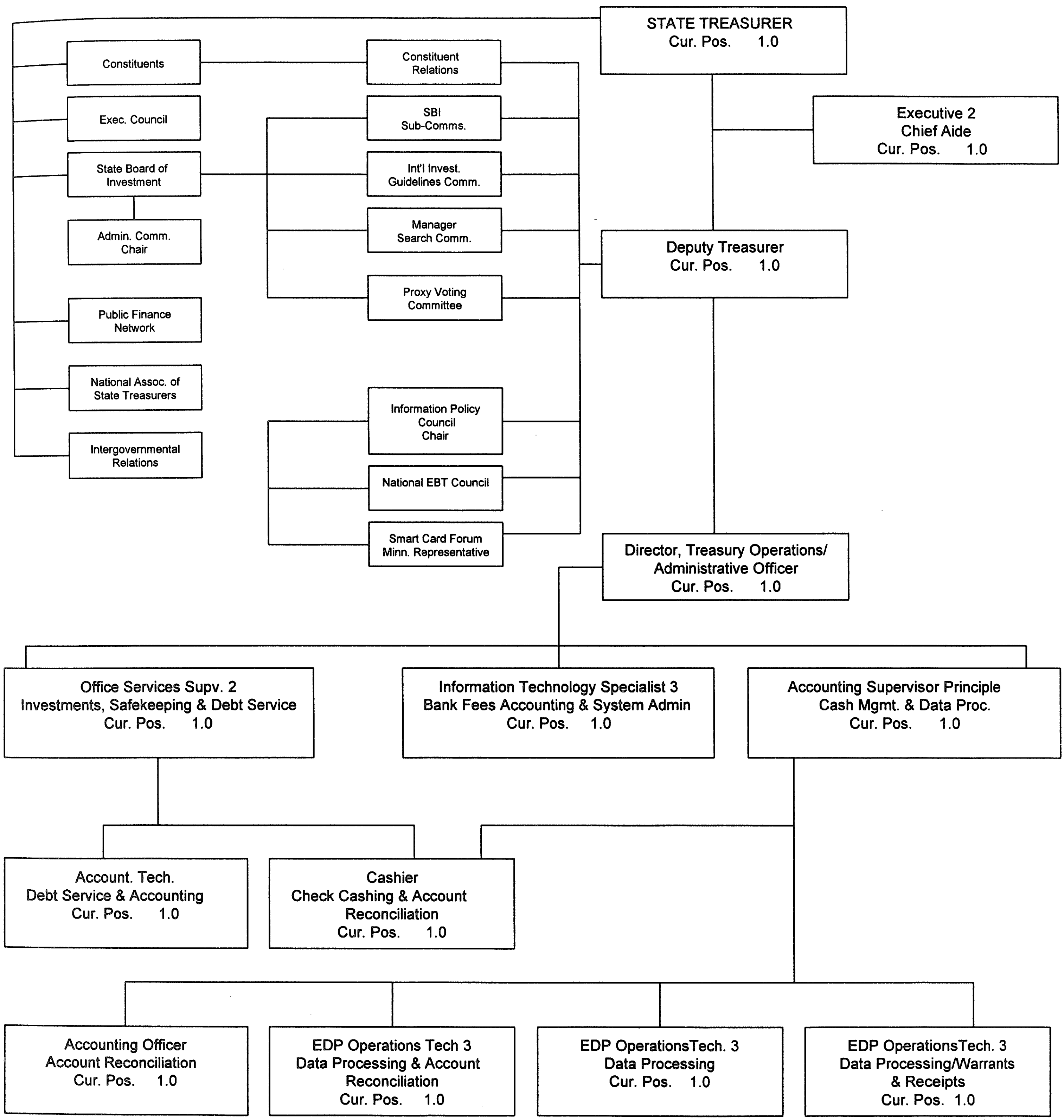
- 1 – Appointed by the Comptroller of Public Accounts, who is elected by the people (Texas).

- 4 – Elected by the State Legislature and function as separate agencies (Maine, New Hampshire and Tennessee, 2-year terms; Maryland, 4-year term).

- 1 – Elected by the people; also serves as the Insurance Commissioner and State Fire Marshall (Florida).

# Appendix F

## Office of State Treasurer
## Organization Chart



## Appendix G

# Treasurer's Office in State Government

**CASH RECEIPTS**