

**REPORT OF THE
STATE AUDITOR of MINNESOTA**

REORGANIZATION OF THE FUNCTIONS OF MINNESOTA'S
CONSTITUTIONAL OFFICERS



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January 14, 1984

Mr. Robert Sheran, Chairman
Governor's Task Force on
Constitutional Officers
c/o Minnesota State Planning Agency
Room 100 Capitol Square Building
St. Paul, Minnesota 55101

Dear Mr. Sheran:

I am today transmitting to your Task Force on Constitutional Offices my recommendations for reorganization of the functions of several constitutional offices and state departments. Before doing so, however, I want to share with you and your task force my concerns about the process Governor Perpich has instituted to "study" Minnesota's constitutional offices.

First, I as State Auditor was neither consulted nor given any advance notice of the formation of the task force. On December 21, 1983 I received a letter from you as chairman indicating that Governor Perpich had created an "Advisory Task Force on Constitutional Offices" to investigate "the problems that now exist with these offices and to make recommendations for changes, (sic) therein". As you know, Minnesota has six constitutional officers, five of whom are individually elected. I for one regard my office as completely separate from the Governor and accountable only to the people of Minnesota. Thus, Governor Perpich's formation of a task force to review functions outside his control, without consultation with other constitutional officers, is a serious mistake.

Second, Governor Perpich has not adequately defined the mission of the task force. His charge to you, as expressed in his news release, is to "make recommendations on the roles and duties of state officials specified in the Minnesota Constitution". While Governor Perpich has expressed a predisposition to eliminate one constitutional office, he apparently does not view the work of your task force to be important enough to warrant his written or oral testimony.

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I can fully appreciate the task force's mandate to study "problems". I am aware of a problem with one constitutional office -- namely that of State Treasurer. It is a problem which revolves around a rather extended absence from Minnesota, and around serious questions involving residency, which will presumably be resolved by a court of law. I am also aware, as you are, of alleged "problems" in the judicial branch from the Supreme Court to the municipal bench; alleged "problems" of conflict of interest on the part of elected officials; and alleged "problems" of misbehavior and self-dealing on the part of Governor Perpich's own appointees. I suggest that reforms may well be needed in all of these areas. Why only in the case of constitutional officers does the Governor propose solving the "problems" by eliminating the office?

Third, the time frame imposed on your task force by Governor Perpich all but precludes thorough, thoughtful study. Your task force was named in late December, is holding two public hearings (the first of which lasted less than two hours) in January, and has been asked by Governor Perpich to submit recommendations by early February. This cursory, superficial treatment of important, complex issues by Governor Perpich leads the general public to conclude that Minnesota's constitutional offices are meaningless and inconsequential. It has cast a cloud over the effectiveness and legitimacy of the Office of State Auditor and has had a detrimental impact on a significant number of our employees.

As is set out in more detail in the body of this report, the State Auditor has a unique and important role in Minnesota's governance, and is currently one of the strongest governmental audit organizations in the United States. Our office has post-audit responsibility for local governments through which seventy plus percent of Minnesota's monies move. We set the accounting and auditing standards for that money -- more than \$5 billion per year. Our staff of 102 performs over 330 audits per year, including all counties, many of the metropolitan agencies, the larger cities, and a variety of regional development commissions. We are one of the largest professional organizations in Minnesota, either public or private.

As you and your task force examine the role and responsibilities of the State Auditor, I want to emphasize two attributes of that position that I feel are mandatory and must be maintained:

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independence and separate accountability to the electorate. When any constitutional office becomes appointive, the system of checks and balances created by the architects of Minnesota's constitution is weakened. The proposal for reorganization I am submitting to your task force today strengthens, rather than weakens, these checks and balances. It maintains the number of constitutional officers, and gives each meaningful responsibilities. I am hopeful that, even within your limited time constraints, you will be able to give the merits of my proposal your thoughtful consideration.

Sincerely,

A handwritten signature in dark ink, appearing to read "Arne H. Carlson". The signature is fluid and cursive, with the first name "Arne" being more prominent.

Arne H. Carlson
State Auditor

AHC:mgt

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FUNCTIONS AND ACCOMPLISHMENTS OF THE OFFICE OF STATE AUDITOR

The efficiency and professionalism of the Office of State Auditor, like other state offices, has varied with the officeholder. In 1976, when the office was under the direction of my predecessor, it was called before the Hennepin County Grand Jury and criticized for 1) not conducting exit interviews with clients prior to release of audits to the press, 2) not systematizing and expanding its audit standards, 3) not seeking legal counsel on major legal questions, and 4) using unnecessarily inflammatory language in its public reports. That is the only time that the Auditor's Office had ever sunk to such a low point.

Improvements

Professionalism. Commencing in 1979, we created two task forces to review the internal and external operations of this office. We brought in people from private accounting firms, the University of Minnesota, the Legislature and private industry in an effort to make this office a national model.

We evaluated each and every employee and during the first year we had an attrition rate of some 27 percent. We reorganized the office and went into the college marketplace and recruited the best and the brightest. We got a separate salary bill passed by the State Legislature which allowed us to compete for the best talent in the marketplace.

We built into the system uniform accounting standards, uniform auditing standards and uniform staff training. We brought in organizations such as the General Accounting Office, private sector firms and academicians in an effort to increase our professional capabilities.

Local Government Accounting. We then looked at how the State of Minnesota was handling the 71 percent of its total budget that went to local government systems and what we found was frightening. Our municipalities did not have uniform accounting; some municipalities still operated on the cash basis of accounting; and out of 87 counties, only six were on the modified accrual basis of accounting. There was a total lack of uniformity in the counties and township systems.

We rolled up our sleeves and created a working partnership with counties and cities and developed uniform accounting across the board. It was not easy. As a matter of fact, two years ago, there was the start of a very strong effort to eliminate our office, our funding and our authority in an effort to prevent this uniformity

from becoming a reality. Had we been an appointed office, there is no doubt in my mind that we would have failed. But our leverage as an independent, elected office allowed us to lobby effectively in support of uniform accounting. In the end, the rational, intelligent voices of the local system prevailed.

Today 81 counties have made the transition to modified accrual accounting and the rest will be completed by 1985. All municipal systems with populations of 2,500 and above are on the modified accrual system utilizing our uniform chart of accounts. We are the first State in the union to have achieved this uniformity, but we did not stop there. We developed uniform accounting for townships and for soil and water conservation districts and then went on to our ultimate goal which was to be able to implement five-year trend analysis.

For the past two years, we have been meeting with municipal and now county officials going over their trend lines relative to expenditures and revenues. For the first time, local governments can now accurately compare costs and begin to understand, from a lay point of view, the value of five-year planning. Had the State of Minnesota been able to do the same, it could have seen that its trend lines were clearly pointing the way toward bankruptcy. As simple as this device may be, that does not in any way take away from its validity.

It was this trend analysis that allowed us to work with then Governor Quie and persuade him of the need to create a task force for the purpose of putting together a five-year plan for the State. That still remains a strong accomplishment of that administration. The private sector has long understood the value of long-term planning, but the government sector has clearly resisted.

We are now working with local governments to lay out twenty-year capital improvement plans so that we can make an orderly response to infrastructure needs. The State of Minnesota definitely needs a comparable plan.

Equal Opportunity and Staff Development. I am also proud to report the accomplishments that we have made relative to the hiring and promoting of minorities and women as well as the significant increase in the number of CPA's. As a matter of fact, our current CPA balance equals or exceeds that of large accounting firms.

When I took office in January of 1979, the audit staff was composed of approximately 60 professional staff members. In 1979, six percent were female and three percent were minorities. Currently 33 percent of the audit staff is female and six percent is minority. This move toward the increased hiring of women and minorities has

also been evidenced within the management portion of the Office of State Auditor. The Director of Audits is a female and we have just promoted the first woman to the position of Division Director. The female and minority members of the staff also occupy other managerial and supervisory positions.

There has been a continued emphasis upon the professionalization of the Office of State Auditor. In 1979, 26 percent of the Office staff were certified public accountants or had conditioned on the CPA exam. At this time, over 60 percent of the audit staff is either certified or in the certification process. We now have five staff members who have law degrees compared with two in 1979. Additionally, four members of our staff hold master's degrees and one holds a PhD. In 1979 there were no staff with either of these advanced degrees.

Office Functions and Responsibilities

Fee-for-Service Operation. This office receives only eight percent of its \$4 million budget from Minnesota's General Fund. The major portion of the agency revenue is provided by fees for the audit service provided by the audit practice section of the office. This part of the office is empowered to make examinations of governmental subdivisions within the State.

Having the largest revolving fund and being so totally self-supporting places additional burdens on the management of this office that are not felt by the administrators in other departments and agencies within the State. Over 90 percent of our budget goes to pay salaries of our employees that are covered under eight different employment agreements.

Because of the funding structure of the Office of State Auditor, any changes in duties or responsibilities must also take into consideration the additional strain and burden that could be placed upon Minnesota's general fund. If the staff size were to be dramatically reduced or the responsibilities changed, many of our employees would be seeking positions in departments that are currently funded by Minnesota's general fund. If this office were combined with another office, any unemployment costs incurred could be the responsibility of Minnesota's general fund rather than the revolving fund monies of the Office of State Auditor.

Compliance with State and National Audit Standards. In the audits of governmental units, there are many standards and pronouncements that must be followed. The General Accounting Office (GAO) has issued its Standards for Audit of Governmental Organizations, Programs, Activities and Functions, which is effective for all audits done on a unit of government that receives federal funds.

These regulations require that an audit of a governmental unit receiving federal funds include a statement of financial position, a statement on the internal controls of the organization and a statement of whether or not the unit of government is complying with all of the laws and regulations that pertain to it.

The General Accounting Office sets the accounting and auditing regulations for federal funds. It revised its "Yellow Book" in 1980 to incorporate the Office of Management and Budget's Circular A-102 Attachment P, the single audit regulations. These regulations were issued to facilitate the auditing of governmental units and to ensure that costs allocated between grants received by one unit of government were accounted for and charged to the appropriate grant. The single audit was intended to minimize gaps and duplications in audit coverage. Before it was instituted, federal grants were audited on an individual basis which resulted in a revolving door effect -- in a given governmental unit, one auditor might be auditing the financial statements and the local funds received, with other auditors coming in to audit the unit's compliance with individual federal grant requirements and frequently other state or federal auditors auditing the unit's compliance with other federal regulations.

Last fall, the U.S. Senate passed a bill (Senate File 1510) which would put into legislation the single audit requirements. Prior to Congress' recess in December of 1983, this same bill was introduced into the House of Representatives (House File 4438).

The GAO's "Yellow Book" also calls for compliance with the pronouncements of the American Institute of Certified Public Accountants (AICPA). The AICPA sets the standards for auditing and generally accepted accounting principles throughout the United States for all practicing CPAs.

The National Council on Governmental Accounting (NCGA) sets generally accepted accounting principles for governments and their pronouncements must also be followed in doing the audit of a governmental unit. Frequently much coordination is needed to comply with all of the regulations, standards and pronouncements that affect the auditing of any unit of government.

Because of the number and complexity of standards that must be followed, there has been a great deal of substandard work in the auditing of governmental units. This has been shown in the annual reviews done by the Minnesota Society of Certified Public Accountants on the audits of municipalities and school districts. The CPA firm of Deloitte, Haskins & Sells did a more extensive review of the audits of municipalities with a population of 2,500 or above. They found that 43 percent of the audit reports did not comply with basic reporting criteria. None of the audits performed by the Office of State Auditor fell into this category.

In a similar review done by the American Institute of Certified Public Accountants on audits submitted to the federal government, almost 60 percent of the reports in their sample did not meet basic reporting criteria.

Other Responsibilities of State Auditor

As a constitutional officer, the State Auditor has broader responsibilities than accounting and auditing. The most important of these is serving as a trustee on the State Board of Investment. For years that Board, consisting of five constitutional officers and a staff of some 27 employees, had been investing money in-house with a minimum of direction and an embarrassingly low rate of return. As the Office of State Auditor sifted through all of the State Board of Investment's data, we began to realize that it was nonsensical, and we embarked upon the first thorough review of this \$5.5 billion fund (now \$7 billion) that has ever been conducted.

In October of 1980, when our office released its critical report, there was not one single ally in the governmental community. Our office stood alone.

We found that at no point since 1973 was the State of Minnesota investing its money at a rate commensurate with inflation or was it able to match the performance of any of the accepted market indexes. From the period July 1, 1973 to January 30, 1980 the annualized rate of return was a mere 4.9 percent while the inflation rate was 9.3 percent. In essence, we were investing money for the purpose of losing it to inflation. Literally hundreds of millions of dollars were being lost.

Fortunately, the State's largest pension fund, the Public Employees Retirement Association (PERA), hired an outside firm to determine the validity of our report. They concluded that we were correct and again sounded the alarm, but still the system resisted. It took us months and months of constant effort to get the system as a whole to understand its flaws and weaknesses and its opportunity for excellence.

Today each and every recommendation made in our October 1980 report has been or is in the process of being implemented and the new staff director proclaims that we now have the opportunity to become the "cadillac" of the industry. We have gone from the laughingstock of the investment community to a state that is being looked at with envy as we diversify the management of our equity and bond portfolios and seek out alternative investments such as real estate, venture capital and resource funds. We even created housing opportunities through a unique partnership with the Minnesota Housing Finance Agency. That partnership came about as a result of the work done by the Office of State Auditor. It produced hundreds

of mortgages, thousands of jobs and at the same time provided a solid investment opportunity for the State Board of Investment.

The Office of State Auditor is today a competent and highly professional organization -- one that the General Accounting Office calls "one of the finest auditing organizations in the United States."

HISTORY OF PAST EFFORTS TO REORGANIZE THE NUMBER AND FUNCTIONS OF THE CONSTITUTIONAL OFFICERS

Historical Perspective on Reorganization

In its deliberations, it is important that the task force consider the history of the constitutional offices in the State of Minnesota. By taking this historical perspective, the long view if you will, we believe the task force will see the wisdom of our founding fathers in providing these independently elected offices. Therefore, we offer the following brief overview of some of the important reorganization studies and statutes involving the State Auditor and respectfully recommend that the task force perform an in-depth review of the rationale for the various changes. We also recommend that the task force undertake a similar study of the other constitutional offices.

This overview is divided into two sections, a summarized discussion of various reorganization studies and a chronological review of some of the more important reorganizations enacted since 1858.

Reorganizational Studies

Perhaps one of the first calls for reorganization was from Governor Eberhart in 1911 and again in 1913. This call resulted in the creation of the Efficiency and Economy Commission in the fall of 1913 and a report issued in May of 1914. As William Anderson notes in his work, History of the Constitution of Minnesota (1921), our original constitution provided for a relatively weak governor which resulted in a proliferation of boards and commissions, all separate and to an extent irresponsible.

According to Anderson:

The result is that the executive and administrative branch of government of Minnesota is really little better off than it has been. The number of boards and commissions is still very large. Many of them are practically independent and not responsive to the control either of the governor or of the people, and there is still some overlapping of functions. The governor is not the real head of the administration, since there are several other executive officers elected by the people who have powers of their own in no way subject to the dictation of the governor.

The next major effort at reorganization perhaps stems from the 1948 Constitutional Commission. The report of the Commission, dated October 1, 1948, calls for the abolition of all constitutional officers with the exception of the Governor, Lieutenant Governor and Attorney General.

It is interesting to note that with the exception of the 1948 report, all subsequent studies such as:

1. The Minnesota Efficiency in Government Commission (Little Hoover Commission) (1950);
2. Modernizing State Executive Organization (1968);
3. Report of the Governor's Council on Executive Reorganization (1968); and
4. Minnesota Constitutional Study Commission (1972)

have called for the abolition of the Attorney General. This function would be transferred to a Department of Law headed by an appointee of the Governor.

The Loaned Executive Action Program (LEAP) of 1973 prescribed much of the present organizational structure. Presumably as foundation, the LEAP report accepted some of the premises of the prior reorganizational studies.

An interesting, but important, sidelight to the LEAP report is its conclusion that the reorganization involving the State Auditor, the Department of Finance, the Public Examiner and the Legislative Auditor would result in no cost savings. Clearly, this is because a function government undertakes requires that someone be in charge and paid a salary. Whether performed by an appointee or a constitutional officer, any undertaking has a cost. The argument for consolidating offices to save money fails to recognize that one individual can only administer so much, the rest must be delegated.

The only rationale we find expressed in these various reports calling for the abolishment of the constitutional offices is that this would consolidate all power of the executive branch in the Governor. The Governor would be the head of the entire administrative branch of government.

These two points, the differing views as to abolishing the Attorney General and consolidating the administrative branch under the Governor, are discussed in the conclusion of this section.

Chronology of Organizational Developments

1858 - Chapter 65: The State Auditor had a term of office of three years and served as the state's accountant and pre-auditor. The State Auditor issued the bills or warrants, payable at the state treasury, used to meet the State's obligations. In addition, the State Auditor annually made out a statement of the receipts and disbursements of the treasury for the preceding year. This statement, together with any remarks the State Auditor had regarding the State's finances, was submitted for the Legislature's review.

1878 - Chapter 83: The Public Examiner was created and the office had a term of three years. The Public Examiner was appointed by the Governor, with the advice and consent of the Senate. The Public Examiner was to be a skillful accountant, well versed as an expert in the theory and practice of bookkeeping.

It was the duty of the Public Examiner to exercise constant supervision over the books and financial accounts of the various state institutions and to prescribe and enforce correct methods for keeping the financial accounts. At least twice each year, at irregular intervals and without prior notice, the Public Examiner was to make an exhaustive examination of the books and accounts of the State institution including the purposes of the expenditures.

The Public Examiner was also to order and enforce a uniform system of bookkeeping to be used by the state and county auditors and the state and county treasurers so as to afford a suitable check upon their mutual action, and insure the thorough supervision and safety of state and county funds.

At least once each year, the Public Examiner was to perform a thorough examination of the books, accounts and vouchers of the county treasurers, ascertaining in detail the various items of receipts and expenditures.

1883 - Chapter 1: An act proposing that the term of the State Auditor be increased from three years to four years. The terms of the Governor, Lieutenant Governor, State Treasurer, Attorney General and Secretary of State remained at two years. The amendment was adopted.

1925 - Chapter 426: The Reorganization Act of 1925 created the Executive Council, the Department of Administration and Finance and the Department of Taxation, among numerous others.

The Department of Administration and Finance was under the supervision and control of the Commission of Administration and Finance. This Commission consisted of three members, one known as the Comptroller, one as the Commissioner of the Budget and one as the

Commissioner of Purchases. The Commission members were appointed by the Governor with the advice and consent of the Senate for initially differing terms (to stagger appointments). The initial terms of office were; Comptroller, six years, Commissioner of the Budget, four years and the Commissioner of Purchases, two years. All subsequent terms were for six years.

The Board of Audit was abolished and all of its duties were transferred to the Comptroller. According to the 1915 Legislative Manual, the State Board of Audit, composed of the Governor, Secretary of State and Attorney General, was required to audit the accounts of the State Treasurer at least four times a year, ascertain the amounts of the several funds which should be in the treasury and count the money actually on hand. A report on the examination was to be made to the Legislature.

The Commission made contracts for the State, fixed grades and salaries for employees, one of its members was to serve as the Director of Personnel among many other duties. This law also abolished the Public Examiner and transferred the function to the Comptroller.

The Comptroller was to keep the books of account and, subject to the approval of the Commission, was to formulate and prescribe for all departments a uniform system of records, accounts, statements, estimates and vouchers. The Comptroller was to prepare and submit to the Commission a summary statement for each of the departments.

The State Auditor was to examine every account, bill, claim and demand against the State and, if approved by the Commission and, if otherwise legal and proper, approve it and issue a warrant for payment. The Comptroller could review any claim allowed by the State Auditor and either approve or disapprove it. The Comptroller was also to require the State Auditor to make periodic reports of all of the receipts and disbursements.

1939 - Chapter 431: This law created the Department of Administration and the Department of Public Examiner, among others.

The Commissioner of Administration was, ex officio, the State Budget Director and the State Purchasing Agent. The Commissioner was appointed by the Governor, with the advice and consent of the Senate, to a two-year term. The Commission of Administration and Finance was abolished, as were the Comptroller, Commissioner of the Budget and the Commissioner of Purchases.

The State Auditor was to maintain the general books of account of the state in accordance with the generally accepted practices in governmental accounting. The State Auditor, with the advice and

assistance of the Commissioner of Administration and the Public Examiner, was to formulate and prescribe a uniform system of accounts, records and statements to be used by all state departments and agencies. The State Auditor was to review all claims for approval and if approved, issue a warrant.

The Public Examiner was appointed by the Governor, with the advice and consent of the Senate, to serve a six-year term. The Public Examiner was to make a post-audit of all State departments and agencies at least once each year and oftener if deemed necessary, or as directed by the Governor or Legislature. The books of the State Auditor and Treasurer were to be examined monthly. The powers and duties of the Board of Audit and the former Public Examiner which were transferred to the Comptroller were placed in the new Public Examiner. In addition, the Public Examiner was to collect information from all local units of government regarding various aspects of local governmental finance and issue an annual report.

The Public Examiner was to inquire into the accounting and budgeting system of all local units of Government and prescribe uniform systems and at the request of a local unit of government, install a system.

1955 - Chapter 857: Although this act was struck down by the Minnesota Supreme Court in Foster v. Naftalin, 246 Minn. 181, 74 NW.2d 249 (1956), it represents another reorganization effort.

This act would have renamed the Department of Taxation the Department of Revenue and transferred the registry tax on mortgages from the State Auditor to the Department of Revenue.

The Department of Administration was to be given broad authority to reorganize State government with the approval of the Governor. The Department of Administration would take over the function of the State Auditor regarding the maintenance of the books of account and prescribing uniform systems of accounts for State departments. The State Auditor would continue to serve as the pre-auditor for State government.

The Office of Legislative Post-Audit would be created and placed in the legislative branch.

1973 - Chapter 492: The Department of Finance was created and the functions of the State Auditor regarding pre-audit, accounting, warrant preparation and prescribing uniform systems for state departments were transferred to it. The budget preparation function of the Department of Administration was transferred to the Department of Finance.

The Public Examiner was abolished and the post-audit function regarding State government was transferred to the Legislative Auditor. The local government post-audit and data collection functions were transferred to the State Auditor. —

Conclusion

Organizations should be built along functional lines with important checks and balances in place. However, certain functions, such as internal audit, post-audit, elections and legal are of a nature that should not be placed within the administrative framework of state government. To function properly, these functions must be separate and apart from the functions they review and advise to maintain the independence so indispensable to objectivity and credibility.

The executive branch, as presently constituted with five independently elected constitutional officers, provides a unique opportunity to bring to the state's system the independence, objectivity and credibility essential to the public trust. The independently elected statewide constitutional office is uniquely qualified to perform functions which call for independence, visibility, lack of parochial interest and public accountability.

Independently elected constitutional officers differ from offices created by statute. The Legislature and the Governor have full control over statutory offices, but the Legislature has only limited control, and the governor none, over constitutional offices. This is the independence which earlier reorganization efforts cited as detrimental. But it is this very independence which provides the opportunity for financial integrity and public trust.

The reorganization studies discussed earlier, with the exception of the 1948 Constitutional Commission, failed to understand the critical need for independence on the part of the Attorney General. The influence of the Governor is wholly inappropriate. The relationship must be that of attorney and client, not that of master and servant.

Similarly with respect to the finances of the State, there are critical functions which must be independent of the Governor's influence. Our proposed reorganization of functions discussed later fulfills this need.

The chronology of the reorganizational statutes demonstrates one thing with absolute clarity -- the concern for control over and accurate accounting for state monies. From the very beginning with the separation of the State Auditor and Treasurer functions,

through the creation of the Public Examiner, the Board of Audit, the Comptroller and the Legislative Auditor, the people of this State have called for accountability regarding its finances. It was not until the 1948 Constitutional study, however, that the difference between segregation of duties, an internal control device, and the concept of independence was understood and recognized.

The 1948 study called for the post-audit function to be placed in the legislative branch of government and not in the executive branch where it had been since the creation of a post-audit function within State government. The 1948 study, however, failed to recognize that, by definition, placing the post-audit function in a constitutional officer achieves independence. Perhaps the attorneys on the 1948 Commission were able to explain to the other members the need for independence on the part of the Attorney General, but the Commission failed to recognize that this important element regarding post-audit can be achieved by placing it in a constitutional office.

All of the earlier reorganizational efforts also failed to recognize the need for and importance of an internal audit function. Since the collapse of New York City in 1975, there has been an increasing recognition that government must achieve a greater understanding and control of its finances. Large corporations have long recognized the importance of internal auditing and indeed have realized that the internal audit function can more than pay for itself. Ideally, the internal audit function is completely separate from management, accountable solely to the Board of Directors. In the State of Minnesota, a constitutional officer is in the best position to assure the degree of independence necessary -- we propose a comptroller to fulfill that function.

Regarding the Secretary of State, which prior reorganizational studies call to be abolished, perhaps the most important function relates to elections. Since Watergate, the voters have become more suspicious of the election process and public officials in general. To address this concern, as well as eliminate a board appointed by the Governor, we concur with the Secretary of State's suggestion that the administration of the Ethics in Government Law be transferred to that office. Election contests, as now, would continue to be determined by the judicial system. Given the vital nature of elections to our democracy and the importance of the Ethics in Government Law, the need for the independence and accountability of the Secretary of State is clear.

Finally, most of the reorganizational studies and statutes attempted to consolidate power in the Governor. This is as it should be. The Governor is elected on the basis of policies. The Governor must sometimes seek legislative authority to implement these policies. Once the policies are in place, the Governor must be in

a position to execute. The best way to achieve this is to be able to appoint people who are accountable to the Governor and subject to the control of that office.

But, again, certain other functions, which in no way impede the Governor's ability to implement policy must be completely independent: questions of law, questions of internal and post-auditing, election questions. These functions, if placed in the administrative branch, are deprived of the independence and direct accountability which instills public trust and confidence in government. By adopting our proposal, the task force recognizes the need for the Governor to be able to control the implementation of policy, but also pays heed to the long, unbroken history of the public's call for accountability. Only independence answers that call.

THE IMPORTANCE OF INDEPENDENT AUDITS

Independence is one of the three general standards of audit work. It is crucial to the auditor's credibility, the belief in his or her clients that the audit will be conducted fairly and honestly. The importance of independence is emphasized in the standards promulgated by the American Institute of Certified Public Accountants, the General Accounting Office, the Financial Accounting Standards Board and the National Council on Governmental Accounting - in short, by all the authorities on accounting and auditing. The Securities and Exchange Commission says it will not recognize any certified public accountant or public accountant as independent who is not in fact independent. The concept of independence is the cornerstone of the auditing profession. It is the climate in which the auditing organization needs to live and breathe and function.

Reputable business firms engage auditors not only to be accountable to stockholders, but also to obtain unbiased information about business operations to use in management decision-making. Larger businesses employ both internal and external auditors. Internal auditors are employed by a firm but retain independence by reporting to the highest practicable echelon, such as the board of directors. External auditors are outside groups hired for the express purpose of expressing an opinion as to the fairness of the company's financial statements and occasionally other aspects of the company.

Similarly, government engages auditors not only to account for funds to the taxpayers, but also to examine its economy and efficiency. In recent years the accounting profession has strengthened its credibility by increasing the stringency of the requirements for auditing, both in government and business. Much of that change has been in increased recognition of the importance of independence in the audits.

One aspect of the significance attached to independence is that it is not sufficient for an auditor to be independent in fact, an auditor must also be independent in appearance with respect to the client. Absolute independence is not possible, because most auditors are hired by the persons or firms they audit, and so have some financial relationship with the client, particularly in the private sector. However, the profession constantly stresses what auditors must do to achieve maximum independence. To be independent, the auditor must be intellectually honest. To be recognized as independent, he or she must be free from any obligation to or interest in the client, its management, or its owners. Because the presumption of independence is incorporated in the profession's code of ethics, it has the force of professional law.

Guidelines stress that auditors, to be independent, must be free from interference in planning and executing the audits, must have free access to records and the cooperation of management in obtaining needed information, and must have no loyalty or obligation to management.

All the strictures apply to all professional accountants. Many professional accountants work as auditors in government, and the government strictures include and often go beyond the professional rules. In fact, government auditors in many ways are more independent than private sector public accounting firms.

The government official in charge of post-audits may be presumed to be independent of the audited entity, assuming there are no personal or external impairments, if he or she is:

1. Elected by the citizens of their jurisdiction.
2. Elected or appointed by and reporting to the legislative body of the level of government which he or she audits.
3. Appointed by the chief executive and confirmed by and reporting to the legislative body of the level of government which he or she audits.
4. Serving in a level of government other than the one which he or she audits (federal, state, local), or
5. Serving in a different branch of government within the level of government which he or she audits (legislative, executive or judicial).

Thus, in Minnesota, for purposes of audit, the elected State Auditor is independent as to all levels and branches of government.

It seems obvious that the maximum independence accrues to the government auditors elected by the citizens. Maximizing independence, then, is when an auditor is organizationally separated from the auditee to the maximum degree possible, and when the auditor reports to the highest practicable echelon, those most removed from daily operational responsibility. In a sense, the elected auditor is reporting to the government's board of directors -- the taxpayers. Whenever an auditor from the Office of the State Auditor audits a city or county, that auditor is fulfilling a legal mandate for the citizens of the state, and fulfilling it with maximum organizational independence. The increased confidence of the audit clients and the public in the Office of State Auditor is the direct result of independence.

It has been argued that a state auditor who is independent of the auditee through legislative process, who has no bookkeeping or accounting function, and who is not involved in pre-audit, achieves more independence than public accountants can; that those auditors elected by the public or even by the legislature can and do attain extreme independence from the accounting systems they audit; that, in fact, if public accountants were to do that type of auditing, their audits should be carefully contracted for, supervised and monitored by state auditors.

Thus, the importance of audit independence cannot be overstated. It is essential to the credibility the taxpayers have for their government. Any consideration of changing a system must take into account the adverse effects any changes would have on that independence, and therefore on credibility and accountability of government throughout the state.

PROPOSAL BY THE STATE AUDITOR FOR REORGANIZATION OF THE
CONSTITUTIONAL OFFICES AND STATE DEPARTMENTS

Recently, many alternatives have been proposed for restructuring the constitutional offices as well as other functional areas of state government. These proposals, however, do not reflect clearly the nature of state government. They do not always recognize the crucial nature of the checks and balances which the Constitution built into the system, nor do they show an understanding of the necessity for separating financial functions and maximizing auditors' independence. They do not always distinguish the current practices of an office from its historical role. Therefore, we offer the following proposal for reorganizing of the constitutional offices and some of the state departments. This proposal ensures the greatest amount of accountability for state finances, promotes efficiency in government and provides the independence indispensable to financial integrity:

1. Place the Department of Revenue's revenue collection function within the Department of Finance to be administered by the Commissioner of Finance, who is appointed by the Governor. This Department would then be responsible for the pre-audit functions, accounting records and the preparation of the financial statements.

REASON -

This places both the receipt and disbursement of that revenue in one department, thus allowing for continuity and increased efficiency in the financial reporting function. Simply stated, the right hand will be aware of what the left hand is doing, that is, the department will be well aware of the availability of revenue for state spending, because it also will collect that revenue.

2. Remove the budgetary and revenue forecasting functions from the Department of Finance, the Department of Revenue and the Department of Administration and place them in a single agency called the Office of the Budget headed by a Commissioner appointed by the Governor. This Office would be responsible for the development and implementation of the state's budget.

REASON -

By placing all of the forecasting functions in one office, the possibility of any duplication of effort will be eliminated. This will reduce conflicts between the budgetary data being used by the Governor's office and that used by the Legislature in their decision-making process.

3. Combine the statewide financial and compliance post-audit function of the Legislative Auditor's office with the local government post-audit function of the Office of State Auditor. This would be headed by an independently elected State Auditor. (Prior to the reorganization of 1973 these two functions were located in the Public Examiner's office.)

REASON -

This would place all of the financial and compliance post-audit function in one office providing for increased efficiency in the use of auditors' time and state funds. Training could be organized more easily and not duplicated. By having an elected official the independence needed for financial integrity would be preserved. The State Auditor's office would express objective, independent opinions as to the fairness of the financial statements of the state and most major local governments.

4. Increase the audit capability of the Program Evaluation Division in the Legislative Auditor's Office to provide the Legislature with the greatest assurance that its policies are achieving the desired program and economic results at both the state and local level.

REASON -

Over seventy percent of the state's operating budget is distributed to local governments, but because of the lack of audit requirements at the state level that money is not necessarily audited. Under the current structure, the Legislature has no independent evaluation mechanism to determine if its policies are being effectively and efficiently executed. By increasing the Program Evaluation Division's responsibilities and capabilities the taxpayers of Minnesota will be assured that their tax dollars are spent in the manner intended.

5. Place the cash management functions of the State Treasurer's Office into the Department of Finance subject to the required internal controls and segregation of duties.

REASON -

The Department of Finance would be responsible for revenue collections; to continue efficiency and accuracy in financial reporting, the cash management function would be placed in this department. This would assure that all revenues would be pooled for maximum investment.

6. Create an Office of Comptroller, which would be an independently elected statewide official responsible for the internal audit function, including economy and efficiency audits. The Management Analysis Division of the Department of Administration would be placed in the Office of the Comptroller.

REASON -

By having an internal audit function with the purpose of reviewing state departments and agencies for economy and efficiency, the state would save many tax dollars by reducing current duplication of efforts among state departments. Aid formulas and grant formulas could be verified before expenditures are made, and the office could determine whether state agencies were following the required internal control structure. All of this would be done prior to the statewide post-audit. Within the business community, it has long been recognized that the existence of an independent internal audit function reaps many monetary benefits by decreasing duplication, increasing efficiency, and promoting financial integrity.

7. Require that the Legislature have an annual financial and compliance audit performed in accordance with generally accepted governmental auditing standards and that its records be accounted for with generally accepted accounting principles.

REASON -

Currently the Legislature is not audited; this would place it under the same requirements as the other branches of state government. This would assure the taxpayers of Minnesota that the tax dollars used by the Legislature are spent in an appropriate manner, thereby enhancing public trust and confidence.

8. The Executive Council would be responsible for contracting the audits of the constitutional offices and the audit of the Legislature.

REASON -

The Executive Council should act much like the Board of Directors of a corporation. In this capacity the Council is responsible for assuring that the constitutional offices and the Legislature undergo independent, objective, and non-partisan financial and compliance audits.

The foregoing organization provides the opportunity for the Governor to be the chief administrator sought by prior reorganization efforts, yet protects the financial integrity of the system by placing independently elected officials in key financial positions. These positions would not encumber the Governor's efforts to implement desired policies, but would improve the functioning of Minnesota government. The independence assured by this proposed reorganization comports with the long history of the state's citizens and taxpayers being concerned that checks and balances exist in state government regarding public finances and other vital functions.

With regard to the other constitutional offices -- the Lieutenant Governor, the Attorney General and the Secretary of State -- we propose:

- 1) That the Lieutenant Governor remain available to perform whatever functions the Governor assigns to that position,
- 2) That the Attorney General remain the Attorney for the State and wholly independent of the Governor, any other constitutional office and the legislative branch, and
- 3) That the Secretary of State remain responsible for the administration of the election laws and, in addition, be assigned the administration of the Ethics in Government Law which currently is administered by a board appointed by the Governor. This would provide direct accountability to the voters of Minnesota.

STATE AUDITOR'S PROPOSAL
FOR REORGANIZATION OF MINNESOTA'S CONSTITUTIONAL OFFICES

Present Responsibilities:

Proposed Reorganization:

<u>GOVERNOR</u> 1) Execution of state laws 2) Budget preparation 3) Ethics in Government Law	<u>GOVERNOR:</u> -Transfer administration of Ethics in Government Law to Secretary of State
<u>STATE AUDITOR</u> 1) Performs local post-audits 2) Prescribes uniform local accounting systems	<u>STATE AUDITOR</u> -Add responsibility for state post-audits now in Legislative Auditor's Office
<u>ATTORNEY GENERAL</u> 1) Renders opinions 2) Represents state in litigation	<u>ATTORNEY GENERAL</u> -No change
<u>SECRETARY OF STATE</u> 1) Administers election laws 2) Secures state filings, laws, etc.	<u>SECRETARY OF STATE</u> -Add responsibility for Ethics in Government Law now in Governor's Office
<u>STATE TREASURER</u> 1) Receives all state funds 2) Keeps state accounts 3) Sends statements to Finance Department 4) Accepts gifts for State	<u>STATE COMPTROLLER*</u> -Performs internal audits now the responsibility of Finance Department and is responsible for Management Analysis Division now in Department of Administration
<u>LEGISLATIVE AUDITOR</u> 1) Post-audits of executive branch 2) State program results audits	<u>LEGISLATIVE AUDITOR</u> -Transfer post-audits of executive branch to State Auditor -Add responsibility for local program results audits (new function)
<u>DEPARTMENT OF FINANCE</u> 1) Prepares budget 2) Responsible for accounting 3) Internal audit (may assign) 4) Promulgates rules for funds deposits 5) Prepares state payroll	<u>DEPARTMENT OF FINANCE</u> -Add administration and enforcement of tax laws now in Department of Revenue -Transfer budget preparation to Office of Budget -Transfer internal audit function to State Comptroller -Add all State Treasurer functions
<u>DEPARTMENT OF REVENUE</u> 1) Economic forecasting for state 2) Administration and enforcement of tax laws	<u>OFFICE OF THE BUDGET*</u> -Prepares budget -Economic Forecasting for state
<u>DEPARTMENT OF ADMINISTRATION</u> 1) Purchasing, accounting and reporting functions 2) Support services, e.g. central mail 3) Responsibility for Management Analysis Division	<u>DEPARTMENT OF ADMINISTRATION</u> -Transfer responsibility for Management Analysis Division to State Comptroller

*Office does not currently exist, would be created

Minneapolis Tribune



Established 1867

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8A.

Tuesday, April 7, 1981

State auditor's independence worth saving

An important issue is at stake in the current skirmishing between Minnesota Auditor Arne Carlson and legislators out to trim his office's budget. The issue: the independence of the state's auditing program.

The need for independence was recognized by the framers of the state's Constitution. They provided for an auditor who would be elected statewide and answerable to the voters. Like Minnesota's other constitutional officers, the auditor is subject to the Legislature's power of appropriation. But even in that respect, the auditor is largely independent of legislative control since, currently, 92 percent of the office's budget comes from auditing fees charged local governments. That is as it should be; to be credible, the office should not only be independent, but also perceived as independent by the public and the agencies it audits.

The current problem is not so much that some legislators are out to trim Carlson's budget — although a House subcommittee recommended bigger cuts in his budget than in those of the other constitutional officers. Rather, the problem is that cuts are being directed at programs and positions without which the office's auditing capabilities would be reduced. For instance, the subcommittee eliminated funding for staff attorneys and criticized Carlson for spending money to train his staff in auditing computerized accounting systems. But attorneys, part of the auditor's staff long before Carlson took office, play a key role in audits. And auditors unfa-

miliar with increasingly common computerized systems would be handicapped in their work. Moreover, it seems inconsistent for the same subcommittee to criticize Carlson's computer-training program, then to increase the secretary of state's budget request to pay for a computerization feasibility study.

Carlson, always a scrappy politician, occasionally ruffles legislative feathers. A few months ago, for instance, he publicly criticized the state investment board's handling of pension funds; some legislators apparently saw that as an effort to embarrass the board's DFL majority. More recently, he moved his office to new quarters, and was criticized for not having obtained legislative authorization first.

But Carlson has also successfully tried to professionalize his office: by adding more certified public accountants; by training programs; by improved procedures; by an emphasis on compliance auditing, which looks not only at balance sheets, but also at whether money is collected and spent in accordance with applicable laws and regulations. As a result of its increased competence, the auditor's office has begun conducting audits for federal agencies. Those are worthwhile accomplishments. Legislators are right to scrutinize budget requests, including Carlson's. But they should not let disagreements with the incumbent prompt them to action that would jeopardize an efficient, independent state auditor's office.

Robert J. O'Keefe

St. Paul Sunday Pioneer Press

March 27, 1983

3D

Drastic change in state government is rarely for the better



State Treasurer Robert Mattson, the best boy of the Democratic-Farmer-Labor Party, has proposed an idea that would wipe out three elective offices and replace them with one.

Mattson proposes that the office, the state auditor's office and the secretary of state's office be dispatched, and their duties given to a comptroller general who would also be elected by the people.

His proposal has generated editorial comment in various newspapers.

A Pioneer Press editorial headline the other day said the plan "merits a hearing." The editorial went on to describe the idea as "misleading" and said that if it is at all feasible it should be submitted to voters for their decision.

A columnist in the *Minneapolis Free Press* implied that he doesn't care much for Mattson, but liked his idea.

I'm in the opposite position.

I admire Mattson, because he has taken on his own political party in primary elections, telling DFLers what they can do with their endorsement. While I had

that political parties certainly have a right to endorse candidates, voters and other candidates, such as Mattson, have an equal right to ignore the endorsements when they're so inclined.

But I look with great wariness at his proposal to do away with three elective offices and replace them with one.

It would be a better idea for the Legislature, or a state commission of some sort, to examine the three offices and determine whether they're busy.

If not, additional duties could be assigned to them.

One aspect of the issue that puzzles me involves the growth we have seen in state government. Anybody who doubts there has been growth needs only to look at the ugly buildings that have risen near the Capitol in recent decades — the *Centennial* Building, the Highway Building, the Veterans Building and the Administration Building.

(If there ever is a serious public works program in the state, one of its first aims ought to be to demolish these monstrosities and build replacements that blend more with our ancient but beautiful Capitol, the Ellsvorth Society building and the old State Office Building, instead of detracting from them.)

The buildings are occupied, and the occupants are state employees, showing how much state government has expanded.

Are we supposed to accept the idea that three state elective offices haven't been affected by this growth and that they have so little to do they ought to be combined into one office? The offices have been in state government since the beginning of statehood, which means they started two years before Abe Lincoln was elected president. How has the growth of state government occupied them?

Another reason I think we should keep the three offices is because the more people who are answerable to voters the better. The work they are doing has to be done by somebody, so why not somebody the voters can bounce out of office?

Another point is that the public should be skeptical about any plan that would make major changes in state government. They aren't as great as they sound.

Remember when we elected governors every two years? Now it is every four years. Political scientists will argue no doubt that four-year terms are by far

the best, because they allow a governor time to accomplish something without worrying about running for re-election the year after he takes office. Others might argue that a governor running for re-election is worried about voters, and having a governor in that position is great.

Another change we made was to have legislators meet every year. There are even legislators ready to admit that was a big mistake.

I haven't heard anybody claim state government today is better than it was when Gov. Orville L. Freeman was serving two-year terms and legislators were holding regular sessions only in odd-numbered years.

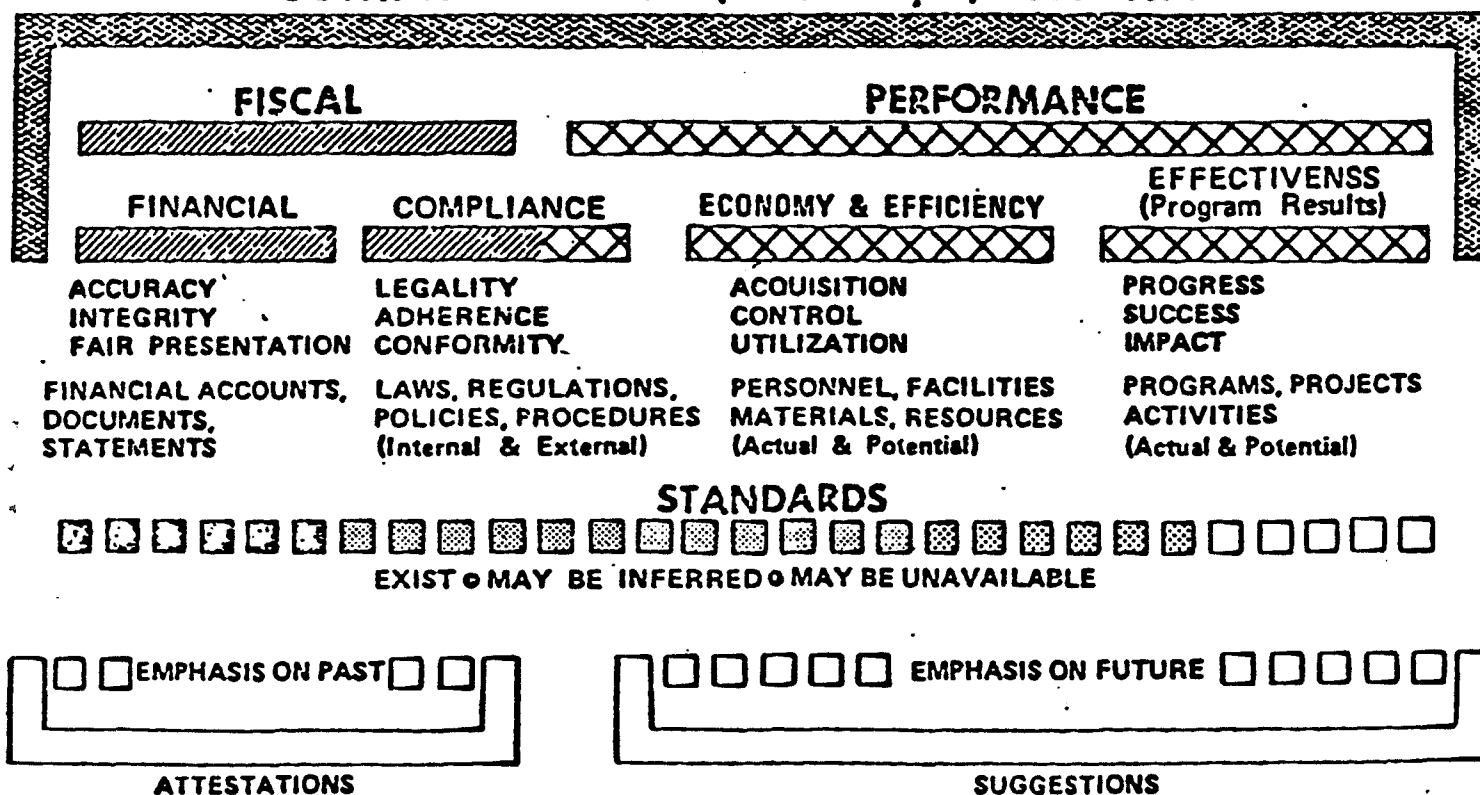
We also decided that the governor and lieutenant governor should run as a team, removing another position from direct control of the voters. I haven't figured out what good it did.

Throw everything together and that's why I think Mattson's proposal should be looked at with care. Maybe it is one of those rare ideas that would change government for the better, but don't bet on it.

O'Keefe covers the Capitol for the *Pioneer Press* and *Dispatch*.

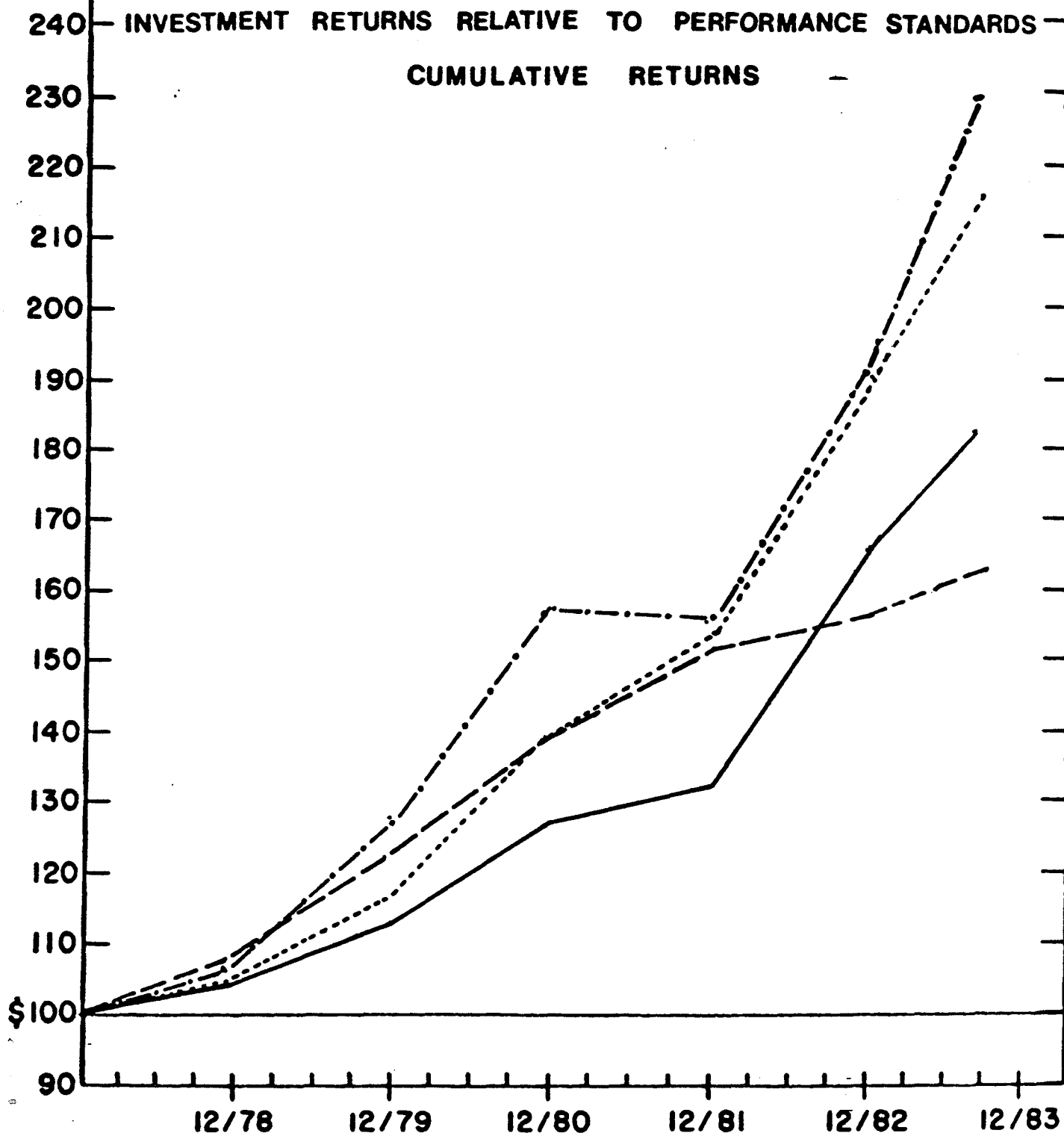
Elements of Expanded Scope Auditing

COMPREHENSIVE (Full Scope) AUDITING



SOURCE: Auditing Public Education

BASIC RETIREMENT FUNDS



- TOTAL FUND RETURN
- MEDIAN TAX-EXEMPT TOTAL FUND
- - - CONSUMER PRICE INDEX
- . . . STOCK/BOND COMPOSITE

BASIC RETIREMENT FUNDS

INVESTMENT RETURNS RELATIVE TO PERFORMANCE STANDARDS

	<u>Total Fund Return (exc. alt. assets)</u>	<u>Median Tax-Exempt Fund</u>	<u>Stock/Bond Composite</u>	<u>Inflation</u>	<u>Total Fund Return (inc. alt. assets)</u>
1978	3.8 %	4.9 %	6.9 %	8.9 %	3.8 %
1979	8.8	11.3	18.8	13.3	8.8
1980	12.4	19.2	24.8	12.5	12.4
1981	3.5	10.0	- 0.6	8.9	3.5
1982	26.4	24.3	22.0	3.8	25.7
1983 1Q	4.8	6.6	9.0	0.3	4.7
2Q	7.1	6.6	9.7	1.6	6.9
3Q	- 2.0	-0.2	- 0.3	1.2	- 1.8
4Q					
1 Year Through 9-30-83	23.9	28.1	37.9	2.8	23.2
3 Years Annualized Through 9-30-83	14.6	15.2	15.6	6.2	14.3
5 Years Annualized Through 9-30-83	11.3	13.0	15.6	8.6	11.1