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OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Financial Audit Division Report

Office of Administrative Hearings
July 1, 2000, through June 30, 2004



MAY 5, 2005

05-26

Financial Audit Division

The Office of the Legislative Auditor (OLA) is a professional, nonpartisan office in the legislative branch of Minnesota state government. Its principal responsibility is to audit and evaluate the agencies and programs of state government (the State Auditor audits local governments).

OLA's Financial Audit Division annually audits the state's financial statements and, on a rotating schedule, audits agencies in the executive and judicial branches of state government, three metropolitan agencies, and several "semi-state" organizations. The division also investigates allegations that state resources have been used inappropriately.

The division has a staff of approximately forty auditors, most of whom are CPAs. The division conducts audits in accordance with standards established by the American Institute of Certified Public Accountants and the Comptroller General of the United States.

Consistent with OLA's mission, the Financial Audit Division works to:

- Promote Accountability,
- Strengthen Legislative Oversight, and
- Support Good Financial Management.

Through its Program Evaluation Division, OLA conducts several evaluations each year.

OLA is under the direction of the Legislative Auditor, who is appointed for a six-year term by the Legislative Audit Commission (LAC). The LAC is a bipartisan commission of representatives and senators. It annually selects topics for the Program Evaluation Division, but is generally not involved in scheduling financial audits.

All findings, conclusions, and recommendations in reports issued by the Office of the Legislative Auditor are solely the responsibility of the office and may not reflect the views of the LAC, its individual members, or other members of the Minnesota Legislature.

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



Senator Ann H. Rest, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

The Honorable Ray Krause, Chief Administrative Law Judge
Office of Administrative Hearings

We conducted an audit of the Office of Administrative Hearings (OAH) for the period July 1, 2000, through June 30, 2004. Our audit scope included fee revenue and payroll and operating expenditures. Our objectives focused on a review of OAH's internal controls over these financial activities and its compliance with applicable legal provisions.

The enclosed Report Summary highlights our overall audit conclusions. The specific audit objectives and conclusions for each area are contained in the individual chapters of this report.

We would like to thank staff from the Office of Administrative Hearings for their cooperation during this audit.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: February 28, 2005

Report Signed On: April 28, 2005

Office of Administrative Hearings

Table of Contents

	Page
Report Summary	1
Chapter 1. Introduction	3
Chapter 2. Fee Revenue	5
Chapter 3. Payroll and Operating Expenditures	7
Status of Prior Audit Issues	11
Agency Response	13

Audit Participation

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

Claudia Gudvangen, CPA	Deputy Legislative Auditor
Brad White, CPA, CISA	Audit Manager
Carl Otto, CPA, CISA	Auditor-in-Charge
John Hakes, CPA	Auditor

Exit Conference

We discussed the results of the audit with the following staff of the Office of Administrative Hearings at an exit conference on April 19, 2005:

Raymond Krause	Chief Administrative Law Judge
Susan Scheisman	Administrative Officer
Seema Siddiqui	Finance Director

Office of Administrative Hearings

Report Summary

Overall Conclusion:

The Office of Administrative Hearings' (OAH) internal controls were adequate, and OAH complied with material finance-related legal provisions; however, we encountered a concern with OAH's controls over cash receipts.

Finding:

- OAH did not adequately control some cash receipts collected by mail or directly by the receptionist. Also, OAH did not deliver some deposits exceeding \$250 to the bank for several days. (Finding 1, page 6)

The report contained one finding related to internal control and legal compliance. OAH resolved four prior audit findings.

Audit Scope:

Audit Period:

July 1, 2000, to June 30, 2004

Programs Audited:

- Fee Revenue
 - Payroll
 - Operating Expenditures
-

Agency Background:

The Office of Administrative Hearings provides a fair and impartial hearing process for those who disagree with actions taken by government. OAH consists of two separate divisions:

Administrative Law Division hears state agency Administrative Procedure Act cases, rulemaking cases, and local government licensing and personnel cases.

Workers' Compensation Division conducts workers' compensation settlement conferences and hears workers' compensation benefit cases.

Office of Administrative Hearings

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Chapter 1. Introduction

The Office of the Legislative Auditor selected the Office of Administrative Hearings for audit based on an annual assessment of state agencies and programs. We used various criteria to determine the entities to audit, including the size and type of each agency's financial operations, length of time since the last audit, changes in organizational structure and key personnel, and available audit resources. It had been four years since our last audit of the Office of Administrative Hearings, and OAH experienced staff turnover in its financial operations.

Agency Overview

The Legislature established the Office of Administrative Hearings in 1976 to provide a fair, prompt, and impartial hearing process for citizens who disagree with actions taken by government. In 1982, the Legislature transferred the workers' compensation benefit hearing function to the Office of Administrative Hearings. On July 1, 1998, the workers' compensation settlement function transferred from the Department of Labor and Industry to OAH. The 2004 Legislature directed OAH to conduct administrative hearings on complaints alleging violations of laws regulating campaign practices. Previously county attorneys investigated these violations with formal proceedings in district court.

The Office of Administrative Hearings is organized into two separate divisions:

- The ***Administrative Law Division*** hears state agency Administrative Procedure Act cases, rulemaking cases, and local government licensing and personnel cases. The division bills state and local governmental units for its services at a rate established to cover its costs.
- The ***Workers' Compensation Division*** conducts workers' compensation settlement conferences and hears workers' compensation benefit cases. The division is funded through Legislative appropriations from the Workers' Compensation Special Compensation Fund. It collects fees to cover its costs for the preparation of records of proceedings that are submitted to the Workers' Compensation Court of Appeals and for the preparation of transcripts.

The Office of Administrative Hearings has its main office in Minneapolis and also has a satellite office in Duluth. A Chief Administrative Law Judge, who is appointed by the Governor for a six-year term, heads the agency. Governor Tim Pawlenty appointed Raymond R. Krause as Chief Administrative Law Judge effective February 2, 2004. Kenneth Nickolai, the former Chief Administrative Law Judge, served from November 1997 until September 2003.

Table 1-1 shows the financial activity of OAH by fund for fiscal year 2004.

Office of Administrative Hearings

**Table 1-1
Financial Sources and Uses by Fund
Fiscal Year 2004**

	Workers' Compensation Fund	Administrative Hearings Fund	Workers' Compensation Transcript Fund <small>(Note 1)</small>
Sources:			
Appropriations	\$7,186,000	\$ 0	\$ 0
Balance Forward In	172,000	729,623	74,697
Receipts	<u>0</u>	<u>1,273,259</u>	<u>7,494</u>
Total	<u>\$7,358,000</u>	<u>\$2,002,882</u>	<u>\$82,191</u>
Uses:			
Payroll	\$5,680,030	\$1,193,308	\$ 0
Professional/Technical Services	76,783	57,436	482
Rent	706,363	73,958	0
Communications	83,377	10,276	0
Travel	43,026	13,256	0
Computer and Systems Services	10,655	2,616	0
Equipment	23,526	6,610	0
Supplies	28,224	4,315	0
Other Expenditures and Encumbrances	<u>29,973</u>	<u>16,970</u>	<u>312</u>
Total	<u>\$6,681,957</u>	<u>\$1,378,745</u>	<u>\$ 794</u>
Balance Forward Out	<u>\$ 676,043</u>	<u>\$ 624,137</u>	<u>\$81,397</u>

Note 1: OAH will begin to allocate court reporter and supply costs to this fund in fiscal year 2005.
Source: Minnesota Accounting and Procurement System as of August 31, 2004.

The Department of Finance performed an internal audit of the Office of Administrative Hearings for the period July 1, 2002, to May 31, 2003, issuing a report in March 2004. This audit identified numerous procedural deficiencies involving procurement and accounts payable, cash receipts, contracts, and capital assets. Since that time, OAH hired a new finance director and implemented procedures to address those concerns.

Audit Approach

Our audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we obtain an understanding of the office's internal controls relevant to the audit objectives. We used the guidance contained in *Internal Control-Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission, as our criteria to evaluate agency controls. The standards also require that we plan the audit to provide reasonable assurance that the office complied with financial-related legal provisions that are significant to the audit. In determining the department's compliance with legal provisions, we considered requirements of laws, regulations, contracts, and grant agreements.

To meet the audit objectives, we gained an understanding of OAH's financial policies and procedures. We considered the risk of errors in the accounting records and noncompliance with relevant legal provisions. We analyzed accounting data to identify unusual trends or significant changes in financial operations. We examined documents supporting the agency's internal controls and compliance with laws, regulations, contracts, and grant provisions.

Chapter 2. Fee Revenue

Chapter Conclusions

The Office of Administrative Hearings' controls ensured it appropriately billed state and local governmental units for administrative law services rendered, properly monitored unpaid receivables, and accurately recorded fees in the accounting records. OAH received most of its revenues by interagency transfers; however, other receipts collected by mail and at the receptionist's counter were not adequately safeguarded or always promptly deposited.

Audit Objectives

Our audit of administrative law fees focused on the following questions:

- Did OAH's internal controls ensure it properly billed state and local governmental units for administrative law services rendered, monitored unpaid balances due, and recorded fees in the accounting records?
- Did OAH adequately safeguard and promptly deposit receipts in compliance with applicable legal provisions?

Background

Minnesota Statutes 14.53 authorizes the Office of Administrative Hearings to bill for the cost of services rendered by its Administrative Law Division. OAH bills those services to state agencies and local government units, such as cities, counties, and school districts. For fiscal year 2004, as directed in its appropriation law, OAH reduced its rates by ten percent to \$135 per hour for administrative law judge time and \$67.⁵⁰ per hour for staff attorney time. It also charged governmental units for business expenses, such as travel, related to the services rendered.

Minnesota Statutes 14.54 established the Administrative Hearings Fund as a revolving account for the activities of the Administrative Law Division. OAH deposits revenue collected into the fund and uses that revenue to pay the costs of operating the Administrative Law Division.

OAH has two forms of revenue: interagency payment transfers and collections received by mail or delivered to the office's receptionist. The largest share of revenue is received from other state agencies using the interagency payment process within the state's accounting system where funds are transferred between accounts. Alternatively, local government units pay by check, requiring OAH staff to collect and prepare receipts for deposit into the state treasury. OAH also collects cash receipts for Workers' Compensation filings and transcripts.

Office of Administrative Hearings

Table 2-1 shows the annual OAH fee revenue by collection type for fiscal years 2001 to 2004.

	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
Interagency Payments	\$ 657,571	\$ 985,874	\$1,363,435	\$1,156,128
Cash Receipts	<u>224,812</u>	<u>391,407</u>	<u>131,932</u>	<u>124,625</u>
Total Revenue	<u>\$ 882,383</u>	<u>\$1,377,281</u>	<u>\$1,495,367</u>	<u>\$1,280,753</u>

Source: Minnesota Accounting and Procurement System.

Current Finding and Recommendations

1. The Office of Administrative Hearings did not adequately control some receipts it collected and did not deposit some funds for several days.

OAH has a computerized system to bill and collect administrative law fees for the majority of its revenue received from other governmental units; however, other cash receipts collected by mail or directly by the receptionist for transcripts, subpoenas, or other records of proceedings are not always controlled with this system or any other internal records. Ideally, a receivable record of sequential invoices and an incoming receipts listing reconciled to deposits would improve control over miscellaneous collections. Financial risks for these receipts are greater due to the physical handling of cash and the need to deliver deposits to the bank.

The office also did not promptly deposit receipts for two of nine deposits we tested. *Minnesota Statutes* 16A.275 requires agencies to deposit receipts daily when accumulating to \$250 or more. On separate occasions, a check for \$2,978 was not deposited for six days, and another check for \$450 was held for six days. In addition to lost interest earnings, holding the receipts onsite rather than depositing them promptly with the bank increases the risk that the cash and checks could be misplaced or stolen.

Recommendations

- *OAH should improve controls over cash receipts by developing a receivable record and a receipts list compared to the subsequent bank deposit.*
- *OAH should ensure it deposits receipts daily when they accumulate to \$250 or more.*

Chapter 3. Payroll and Operating Expenditures

Chapter Conclusions

The Office of Administrative Hearings' controls provided reasonable assurance that it properly compensated staff and other vendors, and that it accurately reported payroll and other administrative expenditures in the accounting records. For the items tested, except as noted in the following paragraph, OAH complied with applicable legal provisions.

During fiscal years 2001 and 2002, OAH did not follow appropriate procurement and accounting practices for operating expenditures. It did not always procure, encumber, or code accounting transactions properly. The current administration has taken the necessary steps to strengthen and improve those practices to an acceptable level.

Audit Objectives

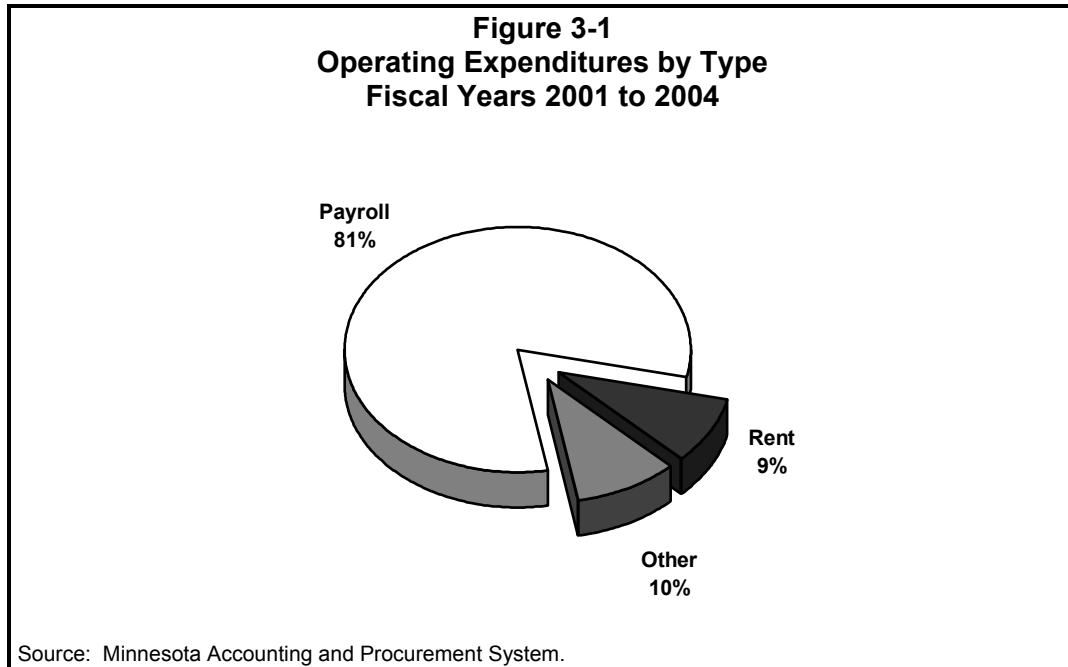
Our review of OAH's payroll and operating expenditures focused on the following questions:

- Did OAH's controls provide reasonable assurance that it accurately compensated staff and paid vendors for goods and services received and properly recorded payroll and operating expenditures in the accounting system?
- For the items tested, did OAH comply with significant finance-related legal provisions, compensation plans, and management's authorization?

Background

OAH spent approximately \$34.2 million during the four-year audit period, averaging \$8.5 million annually for fiscal years 2001 to 2004. Figure 3-1 shows that payroll expenditures are the largest operating cost, comprising 81 percent of the annual spending budget, while rent and other operating costs encompass the remaining 19 percent.

Office of Administrative Hearings



Payroll

OAH averaged \$7 million in annual payroll and fringe benefit costs for fiscal years 2001 through 2004, employing approximately 90 individuals at the end of fiscal year 2004. OAH employees belong to various bargaining units and compensation plans, including the American Federation of State, County, and Municipal Employees, Minnesota Association of Professional Employees, Middle Management Association, Commissioner's Plan, and Managerial Plan.

We noted that one OAH employee had an incompatible ability to update both personnel and payroll functions in the State Employment Management System (SEMA4). OAH justified this in writing to the Department of Employee Relations indicating a limited number of staff were available. As an alternative to separating these incompatible duties, OAH instituted detective controls to independently review timesheet hours and hourly rates recorded on the biweekly SEMA4 payroll register.

Rent

OAH spent an average of \$766,000 each year for office space rent from fiscal year 2001 to 2004. In fiscal year 2004, OAH housed the Administrative Law Division, Workers' Compensation Division, and all administrative services and information technology staff in its Minneapolis office. OAH's only remaining space outside Minneapolis is in its Duluth office. In earlier years, it also had office space rented in Saint Paul and Detroit Lakes. These offices were closed due to budget cuts.

Office of Administrative Hearings

Other Administrative Expenditures

OAH spent approximately \$828,000 each year on other administrative expenditures, including purchased services, professional and technical contracts, communications, travel, supplies, and equipment. Acquisition of many of these goods and services required OAH to follow state procurement channels established by the Department of Administration. However, during fiscal years 2001 and 2002, OAH did not always properly procure goods and services and did not always correctly code administrative expenditure accounting transactions. OAH has taken the necessary steps to change those practices, resulting in improved procurement methods and transaction coding.

Office of Administrative Hearings

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**Status of Prior Audit Issues
As of February 28, 2005**

Legislative Audit Report 01-17, issued in April 2001, covered the five fiscal years ending June 30, 2000. The audit scope included administrative law fees and administrative expenditures. The report contained four audit findings. The most significant finding involved charging of expenditures to an inappropriate funding source. We recommended that OAH transfer \$13,172 to the Workers' Compensation Fund to correct for errors made. We noted improvement in how OAH charges expenditures to each of its funds, and OAH transferred and cancelled the amount questioned. The last audit also reported three other findings, which we found were adequately resolved.

State of Minnesota Audit Follow-Up Process

The Department of Finance, on behalf of the Governor, maintains a quarterly process for following up on issues cited in financial audit reports issued by the Legislative Auditor. The process consists of an exchange of written correspondence that documents the status of audit findings. The follow-up process continues until Finance is satisfied that the issues have been resolved. It covers entities headed by gubernatorial appointees, including most state agencies, boards, commissions, and Minnesota state colleges and universities. It is not applied to audits of the University of Minnesota, any quasi-state organizations, such as metropolitan agencies or the State Agricultural Society, the state constitutional officers, or the judicial branch.

Office of Administrative Hearings

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April 26, 2005

James R. Nobles
Legislative Auditor
100 Centennial Office Building
658 Cedar Street
St. Paul, Minnesota 55155

Dear Mr. Nobles:

This letter constitutes the response of the Office of Administration to the Audit Report of the Office of Legislative Auditor for the period from July 1, 2000 through June 30, 2004.

Finding:

OAH did not adequately control some cash receipts collected by mail or directly by the receptionist. Also, OAH did not deliver some deposits exceeding \$250 to the bank for several days.

Response:

- A. OAH has already implemented a check log at the reception area. Receptionists would be logging the checks before giving them to accounting for deposits. At the end of each month reconciliation would be performed between the check log and the daily deposit register.
- B. It is OAH's policy that receipts will be deposited on a daily basis when they reach a total of \$250.00 or more. Checks totaling less than \$250.00 will be held until they reach the minimum, or for not more than 1 week if the minimum is not met.
- C. OAH is also in the process of hiring an Accounting Technician. This would provide us with an opportunity to cross-train staff in the accounting unit, so if someone is out of the office, the other person can take on the duties. Hence, avoiding the delay in processing deposits, payments and various other time sensitive duties.

Person Responsible: Seema Siddiqui
Completion Date: Implemented on April 1, 2005

This audit has been both informative and beneficial. In our continuing efforts to improve and streamline our operations, the knowledge and expertise that your auditors provided has been extremely helpful.

Sincerely,

/s/ Raymond Krause

Raymond Krause
Chief Administrative Law Judge

Telephone: 612/341-7640