



OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Management Letter

Department of Finance
Fiscal Year Ended June 30, 2000



MARCH 15, 2001

01-11

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 fifty 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 and one best practices review.

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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All OLA reports are available at our Web Site: <http://www.auditor.leg.state.mn.us>

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

Department of Finance

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Audit Participation

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

Claudia Gudvangen, CPA	Deputy Legislative Auditor
Cecile Ferkul, CPA, CISA	Audit Manager
Tony Toscano	Auditor-in-Charge
Susan Kachelmeyer, CPA, CISA	Auditor
Steven Johnson, CPA, CISA	Auditor
Charlie Gill	Auditor
George Deden, CPA	Auditor
Theresa Hahn	Auditor
David Massaglia	Auditor
Sheila Tye	Intern

Exit Conference

The findings and recommendations in this report were discussed with the following officials of the Department of Finance at an exit conference held on March 6, 2001:

Anne Barry	Deputy Commissioner
Lori Mo	Assistant Commissioner, Accounting Services
Douglas Watnemo	Budget Officer
Barb Ruckheim	Financial Reporting Director
Pete Maurer	Financial Reporting Supervisor
Ron Mavetz	General Ledger Supervisor

Report Summary

Key Findings and Recommendations:

- The Department of Finance did not make entries in the accounting system to move cash from the state's General Fund to the Minnesota State College and University system's fund. Until the Department of Finance made the correcting entries in November 2000, the accounting system overstated the General Fund's cash balance by \$51,300,000, and understated MnSCU's cash balance by the same amount. We recommended that the department ensure that it records cash in the proper funds on the state's accounting system. (Finding 1, page 3)
- The Department of Finance did not provide state agencies with adequate direction for certain types of transactions to ensure that the state's financial statements properly present this financial activity. Agencies needed better guidance to properly account for advanced grant funds and reporting encumbrances on some multi-year projects. By improving guidance for these concerns now, the department may prevent a material error in the future. The Department of Finance could also improve its annual requests to agencies for financial statement information. We recommended that the department provide state agencies with guidance in the proper financial statement presentation of advance grant transactions and multi-year projects. We also recommended that the department review its annual requests for agency financial statement data and make revisions to improve the quality of the data submitted. (Finding 2, page 3)

Agency Response:

In its response, the Department of Finance agreed with the report's findings and is taking corrective action to resolve the issues.



OFFICE OF THE LEGISLATIVE AUDITOR
State of Minnesota • James Nobles, Legislative Auditor

Representative Dan McElroy, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Ms. Pamela Wheelock, Commissioner
Department of Finance

We have preformed certain audit procedures at the Department of Finance as part of our audit of the general purpose financial statements of the State of Minnesota as of and for the year ended June 30, 2000. We have also reviewed department procedures related to the state's compliance with certain requirements described in the U.S. Office of Management and Budget's *Circular A-133 Compliance Supplement* that were applicable to the department for the year ended June 30, 2000.

The Department of Finance prepares the state's general purpose financial statements and is responsible for the financial operations of the state. The department manages the state's main accounting systems, coordinates the sale of state general obligation bonds, enters into master lease purchase agreements for state agencies, processes payments of some appropriations and grants, and provides guidance to other state agencies in areas of financial management.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in the *Government Auditing Standards*, issued by the Comptroller General of the United States.

Conclusions

Our December 1, 2000, report included an unqualified opinion on the State of Minnesota's general purpose financial statements included in its Comprehensive Annual Financial Report for the year ended June 30, 2000. In accordance with *Government Auditing Standards*, we also issued our report, dated December 1, 2000, on our consideration of the State of Minnesota's internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts, and grants. In March 2001, we will issue our report on compliance with requirements applicable to each major federal program and internal control over compliance in accordance with the U.S. Office of Management and Budget's Circular A-133.

As a result of our financial statement audit work, we identified some internal control weaknesses, which we discuss in the following findings.

Department of Finance

- 1. The Department of Finance did not make entries in the accounting system to move cash from the state's General Fund to the Minnesota State College and University system's fund.**

Although the Department of Finance established appropriations and spending authority in the Minnesota State Colleges and Universities (MnSCU) Fund for certain capital projects, it did not adjust the accounting system to move cash totaling \$51,300,000 from the state's General Fund to the MnSCU Fund. The Legislature made the appropriations during the 1997 legislative session (\$9,300,000), the 1999 legislative session (\$36,200,000), and the 2000 legislative session (5,800,000).

The state depends on the accounting system as an accurate record of the state's financial activity. Until the Department of Finance made the correcting entries in November 2000, the accounting system overstated the state's General Fund cash balance by \$51,300,000 and understated MnSCU's General Fund cash balance by the same amount. The oversight did not affect the investment of the cash or inhibit MnSCU's ability to proceed with the capital projects funded by the appropriations. Since these funds are combined for financial statement presentation, the error did not result in a financial statement misstatement.

Recommendation

- *The Department of Finance should ensure that it records cash in the proper funds on the state's accounting system.*

- 2. The Department of Finance did not provide state agencies with adequate direction for certain types of transactions to ensure that the state's financial statements properly present this financial activity.**

The Department of Finance could provide better guidance to agencies for the following situations:

- **Advance Grants** – Although the state provides most grant funds on a reimbursement basis, it provides some funds in advance of subrecipient expenditures. For example, the Department of Natural Resources advanced money to some organizations for flood control projects. In its financial statements, the state should recognize expenditures equal to the amount subrecipients expended during the fiscal year. The state should show any unspent advances as prepaid expenses. State agency staff may not be aware that they need this information for proper financial reporting. The agencies also may have to revise subgrantee reporting requirements in order to obtain this information from subgrantees.
- **Multi-year projects** – The time frame of some of the state's projects may span several fiscal years, even several bienniums. Financial reporting problems may occur when agencies encumber funds for project costs that they will pay with dedicated revenue collected in subsequent years. Agencies are uncertain what portion, if any, of the

Department of Finance

encumbrance amount to show as reserved fund balance. Reserving the entire encumbrance amount may result in a negative fund balance, which agencies may be hesitant to report. Consequently, some agencies have underreported encumbrances.

These types of transactions are at a greater risk of financial reporting errors since agency staff may not be aware of the applicable accounting principles related to them. Although errors related to this financial activity have not posed a significant risk, these situations do recur each year and may be more significant in future years. By providing guidance for these concerns now, the department may prevent a material error in the future.

The Department of Finance could also improve its annual requests to agencies for financial statement information. Some requests consistently result in data that financial reporting staff has to further refine or that is not traceable back to the state's accounting system. The department should solicit information about any new types of transactions or initiatives the agencies have undertaken during the fiscal year so that financial reporting staff can determine the financial statement impact of that activity. Also, requests should include the dates by which the department needs the requested data.

Recommendations

- *The Department of Finance should provide state agencies with guidance in the proper financial statement presentation of advance grant transactions and multi-year projects.*
- *The Department of Finance should review its annual requests for agency financial statement data and make revisions to improve the quality of the data submitted.*

This report is intended for the information of the Legislative Audit Commission and the management of the Department of Finance. This restriction is not intended to limit the distribution of this report, which was released as a public document on March 15, 2001.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: January 26, 2001

Report Signed On: March 12, 2001

**Status of Prior Audit Issues
As of January 26, 2001**

March 16, 2000, Legislative Audit Report 00-10 examined the department's activities and programs material to the State of Minnesota's Comprehensive Annual Financial Report and the Single Audit for the year ended June 30, 1999. The scope included general obligation bond sales, debt service transfers, master lease transactions, municipal energy loans, and appropriation transfers to the University of Minnesota. The audit also covered federal requirements relating to cash management and indirect costs. The report contained three findings. The department implemented or substantially implemented all of the recommendations. It coordinated discussion of the proper allocation method for participants of the state's Post Retirement Fund. It designed a monthly system security report to assist state agencies in assessing the appropriateness of security clearances. It gathered information about aspects of the state's system security infrastructure.

September 15, 2000, Legislative Audit Report 00-45 reviewed the integrity of the state's information warehouse as of May 1999. The report contained two findings. The first finding addressed the need for employees with high-level system access to select complex passwords and change those passwords often. The finding also noted several unnecessary accounts with high-level security clearances. The second finding concerned employees who had clearances that were not required by their normal job duties. In its response to the report issues, the Department of Finance agreed with the issues and either had taken corrective action or planned to take the action needed to correct the problems.

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 the metropolitan agencies, or the State Agricultural Society, the state constitutional officers, or the judicial branch.

State of Minnesota
Department of Finance

400 Centennial Building
658 Cedar Street
St. Paul, Minnesota 55155
Voice: (651) 296-5900
Fax: (651) 296-8685
TTY: 1-800-627-3529

March 8, 2001

James R. Nobles; Legislative Auditor
Office of the Legislative Auditor
658 Cedar Street
140 Centennial Office Building
St. Paul, MN 55155-4708

Dear Mr. Nobles:

Thank you for the opportunity for my staff to discuss your audit findings with the individuals in your office responsible for the Department of Finance audit. We are committed to providing accurate financial information to state agencies, the legislature, and the public. We will continue to work toward improvements in our processes.

Recommendation

The Department of Finance should ensure that it records cash in the proper funds on the state's accounting system.

Response

Staff in the general ledger unit and the Executive Budget Officer (EBO) have cooperatively established procedures to ensure that funds are transferred appropriately throughout the year. General ledger staff will review all appropriations made to the MnSCU general fund monthly and adjust accordingly. The EBO assigned to MnSCU will provide a listing of all appropriations to the general ledger unit at the beginning of each fiscal year. Additionally, MnSCU staff will reconcile MAPS accounts at the appropriation level to help assure the accuracy of transactions between the funds.

Person Responsible: Barb Ruckheim, Financial Reporting Director

Implementation Date: Implemented

Recommendation

The Department of Finance should provide state agencies with guidance in the proper financial statement presentation of advance grant transactions and multi-year projects. The Department of Finance should review its annual requests for agency financial statements and make revisions to improve the quality of the data submitted.

Response

Department of Finance staff started working with agencies to improve the recording and reporting of grant advances in August 1999. New MAPS codes were created in June 2000 to separate advances from other grant expenditures. Financial Reporting Unit staff will continue working with agencies to ensure proper reporting of grant advances for the fiscal year ending June 30, 2001. MAPS operating policies and procedures will be modified to provide all state agencies with guidance on the correct processing of grant advances. Additionally, Department of Finance staff will work with agencies to determine the subgrantee reporting requirements needed to obtain accurate information on expenditures made during the fiscal year.

Department of Finance staff will work with agencies that have material multi-year projects to assure that these projects are recorded and reported correctly. MAPS operating policies and procedures will be modified to fully explain the encumbrance procedures for multi-year projects. Department of Finance staff will work with agencies to assure that year-end encumbrances are reported correctly.

Department of Finance will continue to strive to anticipate and be proactive in identifying and resolving potential financial reporting issues or problems. We will continue to work with agencies and improve information requests to ensure compliance.

Person Responsible: Barb Ruckheim, Financial Reporting Director

Implementation Date: September 30, 2001

Sincerely,

/s/ Pamela Wheelock

Pamela Wheelock
Commissioner