OLA
OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Financial-Related Audit

Higher Education Services Office
July 1, 1997, through June 30, 2000

SEPTEMBER 27, 2001 **01-45**

Financial Audit Division

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

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Members of the Higher Education Services Council

Dr. Robert Poch, Director
Higher Education Services Office

We have audited selected financial activities of the Higher Education Services Office for the period July 1, 1997, through June 30, 2000. Our audit scope included: state grants, interstate tuition reciprocity, education resource-sharing programs, and administrative expenditures. The audit objectives and conclusions are highlighted in the individual chapters of this report. We emphasize that this has not been a comprehensive audit of all of the Higher Education Service Office's financial activities.

We conducted our audit in accordance with *Government Auditing Standards*, as issued by the Comptroller General of the United States. Those standards require that we obtain an understanding of management controls relevant to the audit. The standards also require that we design the audit to provide reasonable assurance that the Higher Education Services Office complied with the provisions of laws, regulations, contracts, and grants that are significant to the audit. Management of the department is responsible for establishing and maintaining the internal control structure and for compliance with applicable laws, regulations, contracts, and grants.

This report is intended for the information of the Legislative Audit Commission and the management of the Higher Education Services Office. This restriction is not intended to limit the distribution of this report, which was released as a public document on September 27, 2001.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: June 12, 2001

Report Signed On: September 20, 2001

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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
Brad White, CPA, CISA	Audit Manager
Scott Tjomsland, CPA	Auditor-In-Charge
Ching-Huei Chen	Auditor
Kathy Fisher	Auditor

Exit Conference

We discussed the findings and recommendations with the following representatives of the Higher Education Services Office at the exit conference held on August 27, 2001:

Dr. Robert Poch	Director
Cheryl Maplethorpe	Director, Financial Aid
Ginny Dodds	Manager, State Grants
Gerald Setter	Program Manager
Timothy Geraghty	Director, Financial Services
Danette Jerry	Accounting Officer Senior

Higher Education Services Office

Report Summary

Key Findings and Recommendations:

- The Higher Education Services Office (HESO) did not limit state grant advances to post-secondary institutions to immediate cash needs. Most colleges had large cash balances on hand for extended periods of time. In addition, many schools had to return a significant portion of their advances not needed for grants to students. As a result of the outstanding advances, and difficulty predicting institution summer school needs near fiscal year-end, HESO had a hard time accurately estimating unused state grant funds available for cancellation at the end of fiscal year 2001. (Finding 1, page 7)

- The office lacked an effective separation of duties in the handling of deposits and recording of receipts. We recommended that the office restrict an employee's access to the receipts log. (Finding 2, page 11)

- The office did not adequately monitor Learning Network of Minnesota grantees by requiring that they file financial status reports detailing expenditures and funding match. We also found that six grantee contracts did not contain the required provisions for audit access, contract cancellation, and ownership of materials. (Findings 3 and 4, page 16)

- Improved internal controls were needed to verify the accuracy of amounts billed for vendor loan collection services provided to the office. We recommended that management review and authorize the invoices for payment. (Finding 5, page 19)

- Finally, procedural improvements were recommended for separation of duties over payroll and employee travel reimbursement processing. (Finding 6, page 20)

Background:

The Higher Education Services Office is a component unit of the State of Minnesota primarily responsible for state financial aid grants and loans, and other educational resource-sharing programs. The office's general purpose financial statements are audited annually by a CPA firm. The office is under the leadership of Dr. Robert Poch, Director.

Financial-Related Audit Reports address internal control weaknesses and noncompliance issues during our audits of state departments and agencies. The scope of our work at the Higher Education Services Office included administrative expenditures, state grants, interstate tuition reciprocity, and education resource-sharing programs. This has not been a comprehensive audit of all of HESO's financial activities. The agency's response is included in the report.

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Chapter 1. Introduction

The Legislature created the Higher Education Coordinating Board in 1965 to provide access to higher education for Minnesota's citizens. The board's name was changed in 1995 to the Higher Education Services Office (HESO). The office's responsibilities include the following:

- Administration of financial aid programs at the state level, including accounting, auditing, and disbursing state financial aid funds, and reporting on financial aid programs to the governor and the legislature. State financial aid programs include the state grant program, the state student educational loan fund (SELF) program, and the state work-study program.

- Publishing and distribution of financial aid information, and other materials, to students and parents. The office also collects and maintains student enrollment and financial aid data.

- Approval, registration, and licensure of 52 private, for-profit career schools, and 75 private, post-secondary institutions.

- Administration of the telecommunications council, the Learning Network of Minnesota, and the statewide library task force. The office also negotiates and administers interstate tuition reciprocity agreements with Wisconsin, South Dakota, North Dakota, and the Canadian province of Manitoba.

- Administration of federal programs that affect students and institutions on a statewide basis. It also is involved in the development of policies, procedures, and rules necessary to administer the programs under its supervision.

The Higher Education Services Council, pursuant to Minn. Stat. 136A.011, Subd. 2, appoints the director of the Higher Education Services Office, provides advice and review regarding the performance of the office, and communicates with and makes recommendations to the Governor and the Legislature. The council consists of eight citizens and one student appointed by the Governor. Dr. Robert Poch is the current director of the Higher Education Services Office.

HESO is primarily funded by General Fund appropriations. The Legislature appropriated $136,756,000 and $140,752,000 for fiscal years 1998 and 1999, respectively *(1997 Minnesota Session Laws, Ch. 183, Sec. 2)*, and provided an additional $1 million work-study appropriation for fiscal year 1999 *(1998 Minnesota Session Laws, Ch. 384, Sec 2)*. The Legislature appropriated $149,926,000 for fiscal year 2000 *(1999 Minnesota Session Laws, Ch. 214, Sec. 2)*.
HESO is authorized to issue revenue bonds to provide funding for SELF loans. The office accounts for SELF activity in its Loan Capital Fund. The general purpose financial statements of the Minnesota Higher Education Services Office are audited annually by a CPA firm.

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The Table 1-1 shows the annual financial activity of the office's governmental funds and proprietary fund for fiscal year 2000.

Table 1-1
Governmental Funds
Statement of Revenues, Expenditures, and Changes in Fund Balance
Fiscal Year 2000

	General	Special Revenue	Total
REVENUES:			
State Appropriations	$145,086,955	$ 0	$145,086,955
Federal Appropriations	0	2,295,364	2,295,364
Private Contributions	0	20,000	20,000
Registration and Licensing Fees	0	106,401	106,401
Other Revenue	0	51,119	51,119
Total Revenues	$145,086,955	$ 2,472,884	$147,559,839
EXPENDITURES:			
General Government	$ 4,908,929	$ 1,187,350	$ 6,096,279
Tuition Reciprocity	4,194,867	0	4,194,867
State and Other Grants	135,710,037	0	135,710,037
Federal Grants	0	1,373,038	1,373,038
Total Expenditures	$144,813,833	$ 2,560,388	$147,374,221
EXCESS (DEFICIT) REVENUES OVER EXPENDITURES	273,122	(87,504)	185,618
CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	110,103	0	110,103
EXCESS (DEFICIT) REVENUES OVER EXPENDITURES	383,225	(87,504)	295,721
FUND BALANCE, BEGINNING OF YEAR	(287,943)	349,547	61,604
FUND BALANCE, END OF YEAR	$ 95,282	$ 262,043	$ 357,325

Proprietary Fund
Statement of Revenues, Expenses, and Changes in Net Assets
Fiscal Year 2000

	Proprietary
REVENUES:	
Interest on Student Loans	$ 15,744,699
US Government Interest Allowance	50,617
Recoveries on Defaulted Loans	2,420,652
Total Revenues	$ 18,215,968
EXPENSES:	
General and Administrative Expenses	$ 6,121,406
Provision for Loan Losses	1,766,282
Amortization	59,280
Total Expenditures	$ 7,946,968
OPERATING INCOME	$ 10,269,000
NONOPERATING REVENUES (EXPENSES):	
Investment Income	6,200,062

Interest Expense	(4,898,889)
Total Nonoperating Revenues, Net	$ 1,301,173
INCREASE IN NET ASSETS	$ 11,570,173
NET ASSETS, BEGINNING OF YEAR	259,374,161
NET ASSETS, END OF YEAR	$270,944,334

Source: General Purpose Financial Statements of the Higher Education Services Office for Fiscal Year ended June 30, 2000.

Chapter 2. State Grants

Chapter Conclusion

The Higher Education Services Office established procedures to monitor State Grant Program advances to post-secondary educational institutions and institution disbursements of state grants to students. However, the office did not limit state grant advances to the institutions' immediate cash needs. Most colleges had large cash balances on hand for extended periods of time. In addition, many schools had to return a significant portion not needed for grants to students. As a result of the outstanding advances and difficulty predicting summer school needs near fiscal year-end, HESO had a difficult time estimating unused funds available for cancellation at the end of fiscal year 2001.

HESO received General Fund appropriations to finance the State Grant Program. The program provides grants to eligible Minnesota residents attending eligible post-secondary educational institutions in the state. Eligible institutions include the University of Minnesota, MnSCU two-year and four-year institutions, and private two-year and four-year institutions. Students at several private trade and career schools are also eligible. State grant awards must not exceed the student's recognized cost of attendance at an institution minus the assigned student responsibility of 46 percent, minus the assigned family responsibility as determined by a federal need analysis, minus the amount of a federal Pell grant awarded to the student.

The office utilizes a decentralized delivery system to disburse state grant funds to eligible institutions. The office disburses state grant advances to the institutions based on their estimated state grant awards for each term. The institutions determine student eligibility for state grants, calculate the state grant awards, and disburse the state grants. Institutions periodically submit electronic reports of enrollment and state grant award and disbursement data to the office. The office imports the data into its mainframe database, which contains a series of edits for each disbursement to verify student eligibility and the state grant amount. The office accepts the grant disbursements that pass the edits. At the end of each fiscal year, institutions must return the difference between state grant advances received from the office and the amount of state grant disbursements accepted by the office. If the amount of accepted state grant disbursements exceeds the advances received, HESO will disburse the additional amount to the institution.

Table 2-1 shows the financial activity for the State Grant Program for fiscal years 1998-2001.

Table 2-1
State Grants
Fiscal Years 1998 to 2001

	1998	1999	2000	2001
Appropriation	$98,996,000	$115,121,000	$117,907,000	$128,367,000
Balance Forward In	0	1,974,254	0	3,957,060
Expenditures	96,712,006	113,375,416	113,824,940	120,354,126
Transfers Out	309,740	1,401,397	125,000	225,000
Balance Forward Out	$ 1,974,254		$ 3,957,060	
Cancellations		$ 2,318,441		
Available Balance				$ 11,744,934

Note: Fiscal Year 2001 information is through July 31, 2001. An additional $3.8 million of outstanding state grant advances was held by post-secondary institutions and will be used for summer school grants or returned to HESO.

Note: The State Grants appropriation includes financial activities for state grants, child care, and summer scholarship funding.

Source: Minnesota Accounting and Procurement System (MAPS).

As shown on Table 2-1, the state grant appropriation for fiscal year 2001 had a significant unexpended cash balance remaining. As of July 31, 2001, the appropriation had a state treasury cash balance of about $11.7 million. In addition, state grant advances paid to institutions exceeded state grant disbursements reported to HESO by nearly $3.8 million.

Audit Objectives and Methodology

We focused on the following objectives during our audit of the State Grant Program:

- Did the office establish appropriate cash management practices in its administration of the State Grant Program?

- Did the office properly monitor State Grant Program advances to post-secondary educational institutions and institution disbursements of state grants?

To answer these questions, we interviewed HESO staff to gain an understanding of the procedures to monitor state grant advances to institutions and reporting of institution state grant disbursements to the office. We analyzed decentralized delivery system balances supporting the cash advances and reporting of state grant disbursements. State treasury cash balances were identified throughout the audit period. During the 2001 legislative session, questions were raised regarding the fiscal year 2001 state grant appropriation year-end balances available for cancellation. To address some of these questions, we reviewed outstanding state grant advances and reporting of disbursements for the fiscal year 2001.

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Conclusions

The office established procedures to monitor State Grant Program advances to post-secondary educational institutions and institution disbursements of state grants to students. However, the office did not limit state grant advances to the institutions' immediate cash needs. Most colleges had large cash balances on hand for extended periods of time. In addition, many schools had to return a significant portion of their advances not needed for grants to students. As a result of the outstanding advances and difficulty predicting summer school needs near fiscal year-end, HESO had a difficult time determining unused funds available for cancellation at the end of fiscal year 2001.

1. PRIOR FINDING NOT RESOLVED: The office did not limit state grant advances to post-secondary educational institutions to the institutions' immediate cash needs.

The office did not limit state grant advances to public and private colleges, universities, and trade and career schools to the amounts needed to fund current grant disbursements. Instead, the office advanced state grant funds to institutions based on projected disbursements for an entire term. The office allowed institutions to retain any advances in excess of disbursements until the end of the fiscal year. Many institutions retained excess funds for several months. As of May 2001, institutions held $7.3 million in excess advances anywhere from a few days to several months. For example, the University of Minnesota received an advance of $4.8 million on January 5, 2001, and as of May 17, 2001, still retained $572,582 that it had not yet reported as disbursed. Also in May 2001, Minnesota State University-Mankato held $509,559 and Brown Institute held $645,172 of excess advances over reported disbursements. By not limiting state grant advances to immediate cash needs, the state loses investment income on funds held outside the state treasury. Alternatively, the institutions earn investment income on the undisbursed state grant funds held.

The outstanding advances held by institutions and uncertain levels of summer school state grant funding near fiscal year-end, made it difficult for HESO to determine the amount of unused appropriation available for cancellation back to the General Fund. HESO's state grant system showed that several post-secondary institutions, primarily MnSCU, reported increased state grant needs based on enrollment projections for Summer 2001. Institution enrollment projections were supplied to HESO well in advance of determining actual state grant awards to students. However, HESO had no process to fine-tune or modify projection data until actual award data was uploaded by the institutions at the beginning of each term. In addition, MnSCU's state grant projections assumed all students would attend full-time and counted some students that lost state grant eligibility. We contacted several MnSCU campuses and found that actual summer school state grants awards were several million dollars below the projected levels.

Recommendations

- *The Higher Education Services Office should limit state grant advances to institutions to the institutions' immediate cash needs for state grant disbursements.*

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- *The office should review its system of institution enrollment projection and gathering of state grant awards to provide more accurate and up-to-date information on the status of appropriation funding.*

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Chapter 3. Interstate Tuition Reciprocity

Chapter Conclusion

The Higher Education Services Office properly recorded tuition reciprocity expenditures and receipts in the accounting records. State of Minnesota obligations for interstate tuition reciprocity were accurately based on agreements with the states of Wisconsin and North Dakota. However, we noted a lack of segregation of duties in the handling of deposits and recording of receipts.

Minnesota has interstate tuition reciprocity agreements with Wisconsin, North Dakota, South Dakota, and the Canadian province of Manitoba. The office negotiates the agreements and administers the program. Under the program, students from one state may attend public post-secondary educational institutions in the other state without paying the higher non-resident tuition rate.

The State of Minnesota reciprocity agreements with Wisconsin and North Dakota are the only contracts involving an exchange of funds between the states. Other state agreements simply allow nonresident students to attend at the resident tuition rate without an exchange of money.

- The agreement with Wisconsin includes a method for each state to calculate its reimbursement obligation owed to the other state. The obligation is based on the number of credits taken by resident students at higher education institutions in the other state. At the end of the fiscal year, each state calculates the reimbursement obligation owed and the state with the higher obligation pays the difference to the other state. Money is transferred by December of the subsequent fiscal year.

- The North Dakota agreement provides that the state receiving fewer students from the other state shall reimburse the other state. Historically, more Minnesota students have attended North Dakota institutions. Under the agreement, Minnesota pays North Dakota 50 percent of the estimated obligation for a fiscal year in December of that fiscal year; 25 percent of the estimated obligation at the end of the fiscal year; and the difference between the actual obligation and prior payments in December of the subsequent fiscal year.

The office received General Fund appropriations for the tuition reciprocity program and paid tuition reciprocity obligations from those appropriations. If the office received tuition reciprocity monies from another state, it deposited the receipts as non-dedicated receipts into the General Fund. Table 3-1 shows the tuition reciprocity obligations between states for fiscal years 1997 to 2000.

Table 3-1
Tuition Reciprocity Obligations Between States
Fiscal Years 1997 to 2000

	1997	1998	1999	2000
Obligation to North Dakota	$2,885,204	$4,159,121	$2,656,787	$2,164,719
Obligation to Wisconsin	0	0	2,543,496	2,485,497
Obligation from Wisconsin	(1,308,114)	(2,075,860)	0	0
Total Program Obligation	$ 1,577,090	$ 2,083,261	$5,200,283	$4,650,216

Source: Minnesota Accounting and Procurement System (MAPS).

Several factors caused the shift in the obligation between Minnesota and Wisconsin beginning in fiscal year 1999. The most significant included tuition changes included in a new reciprocity agreement effective for fiscal year 1999. The agreement added a 25 percent surcharge to tuition for Wisconsin students attending the University of Minnesota, and set tuition for graduate students at the higher of the resident rate for each state. These changes increased the amount of tuition paid by Wisconsin students attending Minnesota institutions, which decreased the amount of Wisconsin's tuition reciprocity obligation.

Audit Objectives and Methodology

We focused on the following objectives during our audit of Interstate Tuition Reciprocity:

- Were state obligations for tuition reciprocity accurate based on agreements with the states of Wisconsin and North Dakota?

- Did the office properly record tuition reciprocity expenditures and receipts in the accounting records?

To answer these questions, we interviewed office staff to gain an understanding of the procedures used to calculate tuition reciprocity obligations and record reciprocity expenditures and receipts in the accounting records. We reviewed all the tuition reciprocity transactions to determine if the office accurately calculated reciprocity obligations based on the reciprocity agreements and supporting documentation and properly recorded the transactions in the accounting records.

Conclusions

The Higher Education Services Office properly recorded tuition reciprocity expenditures and receipts in the accounting records. State of Minnesota obligations for interstate tuition reciprocity were accurately based on agreements with the states of Wisconsin and North Dakota. However, we noted a lack of segregation of duties in the handling of deposits and recording of receipts.

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2. The office did not adequately separate duties for the deposit and recording of receipts.

The office employee who deposited receipts and recorded the deposit in the accounting records had inappropriate access to alter the office's electronic receipt log used to record all incoming receipts. The office attempted to separate duties by having an independent employee maintain an electronic log listing all income receipts. Furthermore, a separate individual monthly reconciled deposits recorded in the accounting records to receipts recorded in the log. However, the office gave the employee who deposited and recorded receipts access to the electronic log to record deposit numbers. This created an added risk that receipts could be misappropriated and the log manipulated to avoid detection.

Recommendation

- *The Higher Education Services Office should improve separation of duties by restricting employee access to alter the electronic receipts log.*

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Chapter 4. Educational Resource-Sharing Programs

Chapter Conclusion

The Higher Education Services Office established appropriate monitoring procedures and properly used educational resource-sharing appropriations on activities related to the implementation or operation of those programs. However, we feel the office needs to improve its oversight of Learning Network of Minnesota activities. For the items tested, except for six Learning Network of Minnesota grant contracts which did not contain certain key required provisions, the office entered into valid contracts for program activities and accurately paid vendors based on those contracts.

MINITEX

MINITEX is a library resource sharing program created by the Legislature in 1971 with the mission of facilitating resource sharing among libraries and reducing the cost of providing access to information for residents throughout Minnesota, North Dakota, and South Dakota. The office received General Fund appropriations to operate the program for post-secondary educational institutions in Minnesota. The office also contracted with the Department of Children, Families & Learning for Minnesota public and state agency libraries to participate in the program, and with the states of North Dakota and South Dakota for libraries in those states to participate.

The office contracts with the University of Minnesota to administer the program. The MINITEX office located in the University's Wilson Library employs a staff of 48.33 full-time equivalent employees and 22.5 full-time equivalent student workers. Under the contract, the office disburses the General Fund appropriations and receipts from the contracts with the Department of Children, Families & Learning and the states of North Dakota and South Dakota to the University. Table 4-1 shows the financial activity for the MINITEX program for fiscal years 1998 to 2000.

Table 4-1
MINITEX Program Financial Activity
Fiscal Years 1998 to 2000

	1998	1999	2000
Appropriation	$2,608,000	$2,608,000	$4,498,000
Contract Receipts	802,529	832,224	1,235,215
Disbursements to the University	$3,410,529	$3,440,224	$5,733,215

Source: Minnesota Accounting and Procurement System (MAPS).

The Minnesota Library Information Network (MnLINK)

The office received a $12 million General Fund appropriation in fiscal year 1998 to implement MnLINK, which is a statewide virtual library. The appropriation is available to the office until MnLINK is fully implemented. MnLINK consists of two components: the Integrated Library System (ILS) and the Gateway.

The ILS is planned to be a shared library automation system for the University of Minnesota, MnSCU, Minnesota state agencies, and other participating libraries. The office signed a contract in April 2001 with Ex Libris-USA, Inc., to provide the ILS software. The office expects to begin operating ILS by July 2002.

The Gateway is software that facilitates electronic access to various library resources. It connects the online catalogs of 21 Minnesota library systems so they appear as a single source of information. The Gateway, which began operating in fiscal year 2000, allows users to simultaneously search libraries throughout the state for specified library resources. The office also plans to implement software to enable library users in good standing to request inter-library loan resources from other MnLINK libraries.

Table 4-2 shows the financial activity for MnLINK implementation for fiscal years 1998 to 2000.

Table 4-2
Financial Activity Related to the Implementation of MnLINK
Fiscal Years 1998 to 2000

	1998	1999	2000
Appropriation	$12,000,000	$ 0	$ 0
Balance Forward In	0	11,663,449	10,909,648
Expenditures	336,551	753,801	1,413,260
Balance Forward Out	$11,663,449	$10,909,648	$9,496,388

Source: Minnesota Accounting and Procurement System (MAPS).

In fiscal year 2000, the office received a separate General Fund appropriation of $450,000 for the operation of the Gateway. The office contracted with MnSCU to administer the operations of the Gateway central site and with 21 Minnesota library systems to operate Gateway server sites. The office disbursed the entire appropriation to those organizations.

Learning Network of Minnesota

The Learning Network of Minnesota, created in 1993, is a statewide telecommunications network that provides access to educational programs and library resources through telecommunications technology. The network connects public post-secondary educational institutions, public K-12 education institutions, and public libraries. The Legislature also established the Minnesota Education Telecommunications Council (METC), consisting of 25 uncompensated members from various organizations, to oversee the

network. The office serves as fiscal agent for the higher education portion of the network, which consists of six regional networks throughout the state. An employee of the office serves as the administrator of the METC.
The office received General Fund appropriations to administer the network. It used most of the appropriations for biennial grants to the six regional networks for the operation of the network, and uses the rest for its own administrative costs related to the program. Table 4-3 shows the financial activity for the network for fiscal years 1998 to 2000.

Table 4-3
Learning Network of Minnesota Financial Activity
Fiscal Years 1998 to 2000

	1998	1999	2000
Appropriation	$5,500,000	$5,292,000	$5,178,000
Balance Forward In	0	2,202,952	572
Expenditures:			
Grants	3,219,032	6,013,932	5,078,001
Administrative Expenditures	77,522	55,927	71,271
Transfer Out(1)	494	1,424,521	0
Balance Forward Out	$2,202,952	$ 572	$ 29,300

Note 1: Minnesota Laws for 1997, Ch. 183, Sec. 2, Subd. 6, set aside up to $1.5 million of the fiscal year 1999 appropriation to assist the University of Minnesota in establishing a gigabit capacity point of presence at the University to support their participation in the national Internet two initiative for research and development of telecommunications networks. In fiscal year 1999, the office transferred $1,424,015 to the University, which matched that amount from other sources.

Source: Minnesota Accounting and Procurement System (MAPS).

Audit Objectives and Methodology

We focused on the following objectives during our audit of educational resource-sharing programs:

- Did the office properly use the appropriations for the educational resource sharing programs on activities related to the implementation or operation of those programs?
- Did the office enter into valid contracts for program activities and accurately pay vendors based on those contracts?
- Did the office establish appropriate monitoring procedures to ensure contracted vendors and grantees used state funds appropriately and complied with other provisions specified in contracts or grant agreements?

To answer these questions, we interviewed office staff to gain an understanding of the activities related to each program. We tested samples of expenditures from each program appropriation to determine if they were related to the implementation or operation of those programs. We also reviewed samples of contracts for program activities and determined if the office accurately paid the vendors based on those contracts. Finally, we reviewed the office's monitoring procedures and determined if they were appropriate to ensure vendors and grantees used state funds appropriately and complied with contract provisions.

Conclusions

The office established appropriate monitoring procedures over MINITEX and MnLINK activities. It also properly used the appropriations for the educational resource sharing programs on activities related to the implementation or operation of those programs. However, we found that the office did not properly oversee Learning Network of Minnesota financial activities. For the items tested, except for six Learning Network of Minnesota grant contracts which did not contain certain key required provisions, the office entered into valid contracts for program activities and accurately paid vendors based on those contracts.

3. The office needs to improve its oversight of Learning Network of Minnesota activities.

The office did not establish adequate monitoring procedures to ensure Learning Network of Minnesota grantees used the grant funds appropriately and complied with grant match provisions. We found that the office did not require grantees to periodically submit detailed financial reports to support program expenditures. It also did not include program grantees in its internal audit cycle. Another critical financial requirement involves a ten percent grantee match. The office did not require financial reports to substantiate that the match was provided. Since the office received the program appropriations and is the state's fiscal agent, it has a fiduciary responsibility to oversee the program and ensure program funds are used appropriately. Without financial monitoring and reporting procedures, the office cannot verify grantees used state funds appropriately and complied with the matching requirements.

Recommendation

- *The Higher Education Services Office should establish reporting procedures to ensure Learning Network of Minnesota grantees use grant funds appropriately and comply with grant financial match provisions.*

4. The office omitted certain key provisions from six Learning Network of Minnesota grant contracts.

Six Learning Network of Minnesota grant contracts for fiscal years 2000 and 2001 did not contain certain key required provisions. The omitted items included a contract cancellation clause, a provision allowing HESO and the Legislative Auditor access to audit grantee records, and a clause identifying ownership of materials. Minn. Stat. Section 16C.05, Subd. 5, states that a contract must include an audit clause that "provides that the books, records, documents, and accounting procedures and practices of the grantee, that are relevant to the grant, are subject to examination by the contracting agency and either the legislative auditor or state auditor, as appropriate, for a minimum of six years." Without these key provisions, the office may have limited recourse available if disputes arise with the grantees, may be unable to end the financial arrangement due to lack of funding or other problems, or may have unclear expectations regarding future rights and ownership of assets.

Recommendation

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- *The office should amend the six Learning Network of Minnesota grant contracts to incorporate the missing provisions. The office should establish procedures to ensure all future contracts contain the standard provisions.*

Chapter 5. Administrative Expenditures

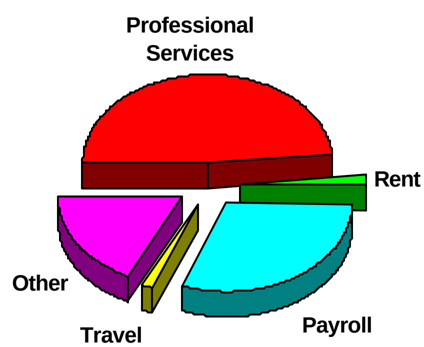
Chapter Conclusions

The Higher Education Services Office's internal controls provided reasonable assurance that it properly compensated its employees, accurately paid vendors, and correctly recorded administrative expenditures in the state's accounting systems. However, we noted that the office needs to improve controls ensuring that one significant vendor is accurately paid for services rendered and that vendor payments are authorized. We also noted the need for separation of duties over payroll and employee expense reimbursements.

For the items tested, except for some minor payroll retroactive adjustment errors, the office accurately paid employees, and processed administrative expenditures in compliance with applicable legal provisions.

The office spent a total of approximately $31 million on administrative expenditures during fiscal years 1998, 1999, and 2000. Our review of administrative expenditures included payroll, professional/technical services, rent, travel and employee expense reimbursements, and other operating costs. Figure 5-1 shows the breakdown of administrative expenditures by type.

Figure 5-1
Administrative Expenditures
Fiscal Years 1998 to 2000



Source: Minnesota Accounting and Procurement System (MAPS).

Higher Education Services Office

Payroll

The office had total payroll expenditures of approximately $9.5 million during fiscal years 1998 to 2000. As of fiscal year 2001, the office had about 87 staff positions. Office staff belong to various compensation plans, including the American Federation of State, County, and Municipal Employees (AFSCME), the Minnesota Association of Professional Employees (MAPE), the Middle Management Association (MMA), and the Commissioner's Plan. The office also developed its own compensation plan, approved by the Department of Employee Relations, for its unclassified employees.

Professional/Technical Services

The office spent approximately $15 million on professional/technical services during the three fiscal year audit period. The office contracted with Eduserv for administering and servicing the SELF loan program until December 1997, when the company went out of business. Beginning January 1998, the office contracted with UNIPAC Service Corporation for those duties. Expenditures to Eduserv and UNIPAC accounted for about 71 percent of the office's professional/technical service expenditures during those years.

Rent

The office had rent expenditures of nearly $630,000 during fiscal years 1998 to 2000. The office moved to its current location in St. Paul's Energy Park in December 1998. Prior to that, the office was located in the since demolished Capital Square building in St. Paul.

Travel and Employee Expense Reimbursements

The office spent about $400,000 on travel and employee expense reimbursements during fiscal years 1998 to 2000. Approximately 53 percent of those expenditures were travel expenditures paid directly to vendor duties, with approximately 47 percent paid to employees as expense reimbursements for travel and other costs. The majority of the office's travel and employee expense reimbursements related to staff trips to post-secondary educational institutions throughout the state.

Other Operating Costs

Other operating costs included spending for supplies, equipment, printing and communications, miscellaneous costs, and special expenses. The office spent over $2.5 million on other operating costs during fiscal years 1998 to 2000.

Audit Objective and Methodology

We focused on the following objectives during our audit of administrative expenditures:

- Did the office’s internal controls provide reasonable assurance that it accurately compensated employees, properly paid vendors for goods and services received, and correctly recorded administrative expenditures in the accounting records?

- Did the office's payroll and administrative expenditure transactions comply with material finance-related legal provisions?

To answer these questions, we interviewed office staff to gain an understanding of the payroll and personnel processes, and the procurement and disbursement processes. We reviewed payroll and personnel transactions and employee travel reimbursements to determine if they were processed in compliance with applicable legal provisions, charged to the appropriate funding sources, and properly recorded in the accounting records. We reviewed expenditure transactions for rent, professional/technical services, and other operating costs to determine if the office complied with applicable legal provisions, accurately paid vendors, and properly recorded the expenditures.

Conclusions

HESO’s internal controls provided reasonable assurance that it properly compensated its employees, accurately paid vendors, and correctly recorded administrative expenditures in the state’s accounting systems. However, we noted that the office needs to improve controls ensuring that one significant vendor is accurately paid for services rendered and that vendor payments are authorized. We also noted the need for separation of duties over payroll and employee expense reimbursements.

For the items tested, except for some immaterial payroll retroactive adjustment calculation errors, the office accurately paid employees, and processed administrative expenditures in compliance with applicable legal provisions. We found five minor instances where the office underpaid employees, ranging from $3 to $269. We also found two minor overpayments for $12 and $35. We requested that office management review these small errors and determine whether corrections are necessary.

5. The office needs to improve controls ensuring the accuracy and authorization of payment for certain vendor invoices.

We noted certain weaknesses existed in the office’s internal controls ensuring the proper authorization and accuracy of certain vendor invoices:

- The office is unable to verify the accuracy of amounts invoiced by UNIPAC for loan collection services. UNIPAC submitted monthly invoices to HESO for administering and servicing the SELF loan program. The invoices listed the types of services provided and contract rate for the various types of loans. However, UNIPAC did not provide sufficient documentation supporting the number of loans for each type of service, and the office could not independently verify that information. Without verifying the number of loans included on the invoices, the office risks overpaying UNIPAC for those services. In fiscal years 1998 to 2000, the office paid UNIPAC nearly $9.3 million or approximately $3.1 million annually.

- The office did not formally authorize payment of certain invoices. An office employee who worked with the SELF loan program indicated that staff reviewed the UNIPAC invoices to determine if the number of loans serviced appeared reasonable, but they did not sign the invoices. We also found that the office's contract representative only authorized three of seven invoices tested. The final payment, which the contract stated would be paid only after the office was satisfied that work was satisfactorily completed, was not signed. The lack of formal invoice payment authorization increases the risk that HESO could inappropriately pay vendors for unsatisfactory or uncompleted work, make payments at incorrect rates, or make duplicate payments.

Recommendation

- *The office should improve controls over UNIPAC vendor payments by:*

  -working with the vendor to establish procedures and documentation requirements to allow verification of the accuracy of amounts invoiced; and

  -providing formal management authorization of invoices for payment.

6. The office needs to improve separation of duties over payroll and employee expense reimbursements.

Three internal control weaknesses were noted concerning the processing of the office's payroll and employee expense reimbursements:

- The office did not properly restrict employee access to SEMA4. The office gave its two human resources employees incompatible access to perform full-service payroll functions. Ideally, personnel and payroll functions should be performed by separate individuals. The office did not document, pursuant to Department of Employee Relations security policies, the need for these employees to have the incompatible access. These employees do not require access to payroll functions to perform their job duties.

- The office did not provide for an independent review of the SEMA4 Payroll Register. The same individual who enters the transaction was responsible for verification of input. The Department of Finance policy PAY00028 requires an agency employee independent of data entry to review the SEMA4 output reports for accuracy of the transactions being processed. We also noted one employee calculated and authorized their own retroactive pay adjustment without an independent review. Without proper separation of duties, employees entering payroll and processing special transactions could manipulate their own expenditures to benefit themselves, without detection.

Higher Education Services Office

- Segregation of duties related to processing employee expense reimbursements could be improved. The individual who is responsible for input of employee expense reimbursement transactions, including her own, also reviewed the SEMA4 output reports to verify the accuracy of the data entry.

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Recommendation

- *The Higher Education Services Office should improve controls over payroll and employee expense reimbursement processing by:*

  -restricting human resources employees' access to SEMA4 payroll functions;

  -providing for an independent review of the SEMA4 Payroll Register to verify the accuracy of hours, payrates, and special transactions; and

  -separating duties for verification of input of employee expense reimbursements.

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Status of Prior Audit Issues
As of June 12, 2001

Legislative Audit Report 93-24, issued in May 1993, covered the three fiscal years ending June 30, 1992. The audit scope included the state grant and state work-study programs, and contractual services. The Higher Education Services Office did not resolve an issue regarding cash management of state grant funds. We repeat that issue as Finding 1 of this report. The office resolved the other two findings contained in the audit report.

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.

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Minnesota Higher Education Services Office

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September 18, 2001

Mr. James R. Nobles
Legislative Auditor
Office of the Legislative Auditor
Room 140, Centennial Building
658 Cedar Street
St. Paul, MN 55155-1603

Dear Mr. Nobles:

With this letter the Minnesota Higher Education Services Office (HESO) conveys its response to the audit report prepared by your office on selected HESO financial activities. We appreciate the professional manner in which the audit was conducted and believe that our financial operations and processes are improved as a result.

Our agency will work diligently to ensure that the key findings and recommendations contained within the audit continue to be addressed responsibly. We are also convening meetings with college and university representatives to address specific points within the audit.

Thank you for a positive and productive audit process.

Sincerely,

/s/ Robert K. Poch

Robert K. Poch
Director

cc: Claudia J. Gudvangen
Brad White

Higher Education Services Office

Recommendations

1A. The Higher Education Services Office should limit state grant advances to institutions to the institutions' immediate cash needs for state grant disbursements.

HESO Response:

In addressing this finding, the Higher Education Services Office needs to meet the needs of the state for responsible cash management and also the need to provide efficient and timely service to students receiving Minnesota State Grants. HESO and schools strongly support the decentralized delivery system used to administer State Grants at the campus level. By advancing funds and allowing schools to award State Grants and disburse funds on campus, the decentralized system has eliminated the significant delays and bottlenecks associated with the centralized system. Under the centralized system, it was not uncommon for students to have to wait two to three months to receive their State Grant award notice and disbursement. The decentralized system was designed to allow schools to earn interest on unexpended State Grant funds throughout the term in order to recognize the additional costs associated with administering the program on campus. By administering the program on campus, a student can apply for and receive a grant in a matter of days, and schools have been able to do a better job screening applications.

HESO discussed this audit finding with the Financial Aid Advisory Committee, which is made up of financial aid administrators from the various types of schools participating in the program. All agreed that conversion to a system of cash reimbursement to schools (as opposed to advances) would have a negative impact on students because many schools do not have the financial resources to cover State Grant payments until reimbursement takes place. HESO staff and aid administrators were also concerned that a cash management system which required that funds be spent within 3 days, as is required for federal aid programs, would increase the reporting volume to a level that current HESO staff could not process batches and funds requests in a timely manner, which would also have a negative impact on students.

However, HESO does recognize the need for improved cash management and believes the following adjustments will reduce the amount of unexpended funds held by participating campuses:

Higher Education Services Office

1. A school's initial funds advance to cover State Grant disbursements for the first term of the aid year will not be made unless the school has closed out for the preceding aid year and submitted a State Grant Decentralized Delivery System batch to HESO for the new aid year which is suitable for running in the production database.

2. Currently, a school's initial advance is based on prior year spending for the initial term of the previous aid year. HESO will limit the initial advance to 90 percent of the initial advance from the previous aid year. The school can then request additional funds during the term.

3. Funds requests for subsequent terms of the aid year will be adjusted by HESO to reflect previous year spending patterns. Typically, enrollments drop after fall term, therefore, HESO will limit funds advances accordingly. For example, if a school's spring semester payments in the preceding year were equal to 80 per cent of fall semester disbursements, the school's funds advance for spring semester of the new aid year will be limited to 80 per cent of fall disbursements. Furthermore, HESO will then only disburse a percentage (90 percent) of the adjusted advance request at the onset of the subsequent term. The school can then request additional funds during the term.

4. Throughout the aid year, HESO will monitor monthly spending reports to determine if any school's balance of unexpended funds exceeds a reasonable amount. Such schools will be notified to return funds to HESO unless they can document need for those funds during the term in question.

Persons Responsible:

Ginny Dodds
Robert Poch
Cheryl Maplethorpe
Tim Geraghty
Jerry Setter

Time Frame: Work on these items has begun and will continue throughout the fiscal year.

1B. *The office should review its system of institution enrollment projection and gathering of state grant awards to provide more accurate and up-to-date information on the status of appropriation funding.*

HESO Response:

HESO is reviewing its enrollment projection process and, as part of that review is consulting with management personnel within the respective sectors of Minnesota higher education to examine ways of receiving more accurate and timely information from post-secondary institutions.

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Persons Responsible:

Jerry Setter
Robert Poch
Ginny Dodds

Time Frame: Work on these items has begun and will continue throughout the fiscal year.

2. *The Higher Education Services Office should improve separation of duties by restricting employee access to alter the electronic receipts log.*

HESO Response:

Password restrictions have been placed within the electronic receipts log. Employees who process deposits cannot access tables where receipts are recorded. There is a separate view table for the employee who processes deposits to enter the corresponding deposit numbers.

Person Responsible:
Tim Geraghty

Time Frame: Completed.

3. *The Higher Education Services Office should establish reporting procedures to ensure Learning Network of Minnesota grantees use grant funds appropriately and comply with grant financial match provisions.*

HESO Response:

Grantees will submit a semi-annual and final report each fiscal year. These reports will be monitored by the Manager of the Learning Network of Minnesota. In addition, the Learning Network of Minnesota grantees will be subject to periodic audit by internal HESO audit staff.

Persons Responsible:
Emily Kissane
Tim Geraghty

Time Frame: These activities will begin this fiscal year and will continue thereafter.

4. *The office should amend the six Learning Network of Minnesota grant contracts to incorporate the missing provisions. The office should establish procedures to ensure all future contracts contain the standard provisions.*

HESO Response:

The six Learning Network of Minnesota grant contracts have been amended to incorporate the missing provisions.

Higher Education Services Office

Persons Responsible:
Emily Kissane
Tim Geraghty

Time Frame: Completed**.**

5. *The office should improve controls over UNIPAC vendor payments by:*

   -working with the vendor to establish procedures and documentation requirements to allow verification of the accuracy of amounts invoiced; and

   -providing formal management authorization of invoices for payment.

HESO Response:

The Higher Education Services Office has implemented a process to verify invoiced amounts from UNIPAC for student loan servicing. Monthly data downloads are obtained from UNIPAC and analyzed by HESO staff. Monthly invoices from UNIPAC, upon verification, are approved for payment by the Manager of the SELF loan program and the Director of Financial Services.

Persons Responsible:
Tim Geraghty
Marilyn Kosir

Time Frame: Completed.

6. *The Higher Education Services Office should improve controls over payroll and employee expense reimbursement processing by:*

   -restricting human resources employees' access to SEMA4 payroll functions;

   -providing for an independent review of the SEMA4 Payroll Register to verify the accuracy of hours, payrates, and special transactions; and

   -separating duties for verification of input of employee expense reimbursements.

HESO Response:

Access to SEMA4 payroll transactions for HESO Human Resources employees has been changed and restricted. These employees can no longer process payroll transactions.

The supervisor for employees who process payroll will now be reviewing the payroll register for accuracy.

Higher Education Services Office

Appropriate Financial Services staff have been notified they are not to process their own expense reports. Periodic review of processed expense reports will be done by supervisory staff.

Persons Responsible:

Tim Geraghty

Time Frame: Completed.