



OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Management Letter

**Department of Trade and
Economic Development
Fiscal Year Ended June 30, 2001**



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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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 Trade and Economic Development

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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
Pat Ryan	Auditor-in-Charge
Dave Massaglia	Auditor

Exit Conference

We discussed the finding and recommendations with the following representatives of the Department of Trade and Economic Development at an exit conference on February 13, 2002:

Bonnie Burt	Senior Administrative Officer
Judy Kislenger	Accounting Manager
Louis Jambois	Senior Executive Officer

Report Summary

Key Finding and Recommendations:

- The department did not reflect recent changes to its Rural Challenge Grant loan program in the accounting system. The change allowed the loan monies to be retained at the regional level, rather than being repaid into the state treasury and reissued back to the same region. The department began disbursing new regional funding as grants and discontinued collecting loan repayments from the regional organizations. However, funds previously issued as loans remained on the accounting system as loans receivable. As a result, an audit adjustment for \$7 million was necessary to eliminate the loans receivable balances reported in the state's financial statements. In addition, we noted that state statutes need to be clarified in light of recent structural changes to the program. (Finding 1, page 3)

Management letters address internal control weaknesses and noncompliance issues found during our annual audit of the state's financial statements and federally funded programs. The scope of work in individual agencies is limited. During the fiscal year 2001 audit, our work at the Department of Trade and Economic Development focused on financial activities of the Agriculture and Economic Development Fund, three loan programs in the Special Revenue Fund, and one federal program administered by the department. The department's response to our recommendations is included in the report.



OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

Senator Ann H. Rest, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Ms. Rebecca Yanisch, Commissioner
Department of Trade and Economic Development

We have performed certain audit procedures at the Department of Trade and Economic Development as part of our audit of the financial statements of the State of Minnesota for the year ended June 30, 2001. We also have audited certain federal financial assistance programs administered by the Department of Trade and Economic Development as part of our audit of the state's compliance with the requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement*. We emphasize that this has not been a comprehensive audit of the Department of Trade and Economic Development.

Table 1 identifies the financial activities within the Department of Trade and Economic Development that were material to the state's financial statements. We performed certain audit procedures on these programs as part of our objective to obtain reasonable assurance about whether the State of Minnesota's financial statements for the year ended June 30, 2001, were free of material misstatement.

Table 1
Programs Material to the State's Financial Statements
Fiscal Year 2001
(in thousands)

<u>Balance Sheet Accounts</u>	<u>Amount</u>
Agriculture and Economic Development Fund	
- Cash and Investments	\$36,958
- Bonds Payable	\$37,445
- Business Loans Receivable	\$22,644
Special Revenue Fund:	
- Tourism Loans Receivable	\$2,800
- Rural Challenge Loans Receivable	\$0
- Urban Challenge Loans Receivable	\$3,834
<u>Expenditure Area</u>	
Building Fund:	
- Duluth Entertainment and Convention Center	\$5,058
Construction Grants	

Source: *State of Minnesota Comprehensive Annual Financial Report* for fiscal year 2001.

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The Department of Trade and Economic Development also manages and reports the governmental and proprietary fund financial activities of the Public Facilities Authority. These financial activities are audited by a certified public accounting firm and reported as a component unit in the State of Minnesota's financial statements.

Table 2 identifies a State of Minnesota major federal program administered by the Department of Trade and Economic Development. We performed certain audit procedures on this program as part of our objective to obtain reasonable assurance about whether the State of Minnesota complied with the types of requirements that are applicable to each of its major federal programs.

Table 2
Major Federal Program Administered by the
Department of Trade and Economic Development
Fiscal Year 2001
(in thousands)

<u>CFDA #</u>	<u>Program Name</u>	<u>Federal</u>
14.228	Community Development Block Grant	\$33,920

Source: *State of Minnesota Financial and Compliance Report on Federally Assisted Programs* for fiscal year 2001.

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

Conclusions

Our December 7, 2001, report included an unqualified opinion on the State of Minnesota's general purpose financial statements for fiscal year 2001. In accordance with *Government Auditing Standards*, we also issued our report, dated December 7, 2001, on our consideration of the State of Minnesota's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. At a later date, we will issue our report on compliance with requirements applicable to each major federal program and internal control over compliance in accordance with OMB Circular A-133.

As a result of our procedures, we identified the following weakness in internal control at the Department of Trade and Economic Development.

1. The department did not accurately account for certain loans in the state's accounting system.

Two concerns were noted with recent changes to the Department of Trade and Economic Development's Rural Challenge Grant loan program. We found that the department made changes to the financial management of the loan program that were not properly reflected in the state's accounting system. The change essentially allowed loans to revolve at the regional level

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instead of being repaid into the state treasury and reissued back to the regional organization. However, since the department eliminated its role in handling recoveries of these loans, the statutory language regarding directing of loan repayments is in need of clarification.

During fiscal year 2001, the department changed the financial management of its Rural Challenge Grant loan program. The department discontinued issuing new loans and collecting repayments on prior loans. It also transferred the \$7,365,578 loan portfolio to existing regional non-profit organizations that oversee the revolving fund loans to private entities in their area. However, the department did not initiate adjustments in the state's accounting system to reflect this decision. It continued to show \$7,365,578 in loan receivables as of June 30, 2001. An audit adjustment was necessary to reduce the balance initially reported in the financial statements.

The department's changes during fiscal year 2001 eliminated the revolving loan fund activity at the state level. Until December 2000, the department issued the loans from the state treasury and loan repayments were deposited back into the state treasury. It reflected outstanding balances as loan receivables in the state's accounting system. In January 2001, the department discontinued issuing these funds as loans and began disbursing new funds as grants to the regional non-profit organizations. At that time, it also discontinued collection of repayments for loans previously issued in prior fiscal years. We questioned the department's decision to make this funding change, however, the department requested advice from the Office of the Attorney General regarding its ability to grant these funds to the regional organizations. The Office of the Attorney General concluded that the department's use of the funds appeared consistent with the intent of the law. The change essentially allowed the loan monies to revolve at the regional level instead of being sent into the department and reissued back to the region.

We feel that the statutory language in Minn. Stat. Chapter 116J, governing the Rural Challenge Grant program, needs clarification in light of the shift of loan responsibility to the regional level. Minn. Stat. 116J.955 authorizes a **state** rural rehabilitation revolving account in the state treasury to provide loans to new and expanding businesses in rural Minnesota to promote economic development. Minn. Stat. 116J.415 establishes **regional** revolving loan funds and further provides that state funding may not exceed 50 percent for each loan while the remaining 50 percent is funded from non-state sources. As the loans are repaid, Minn. Stat. 116J.415, Subd. 7, requires that *"loan repayment amounts equal to one-half of the principal and interest must be deposited into the [state] rural rehabilitation revolving fund for challenge grants to the region from which the money was originally designated. The remaining amount of the loan repayment may be deposited in the **regional** revolving loan fund for further distribution by the regional organization."* This language specifies that principal and interest be deposited into the state's rural rehabilitation revolving account before it is returned to the region for funding new loans. In light of the recent changes to shift loan collections from the department to the regional level, the statutory language does not address current practices. The Office of the Attorney General also indicated that the statutes governing the rural rehabilitation revolving account are not clear. They indicated that certain language regarding the use of principal and interest appeared to be contradictory.

We found that the department does provide oversight of the regional non-profit organizations that manage these loans. It requires the regional non-profit organizations to maintain separate

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accounts for the funds and keep records showing loans issued, principal repayments, and interest received. Financial reports and independent audit results are sent to the department for review. Onsite visits by the department are also performed twice per year.

Recommendations

- *The Department of Trade and Economic Development should work with the Department of Finance to correct the Rural Challenge Grant loan receivables balance in the state's accounting system.*
- *The department should initiate clarification to Minn. Stat. Chapter 116J regarding the handling of Rural Challenge Grant loan principal and interest repayments at the regional level.*

This report is intended for the information of the Legislative Audit Commission and the management of the Department of Economic Security. This restriction is not intended to limit the distribution of this report, which was released as a public document on March 1, 2002.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: December 20, 2001

Report Signed On: February 25, 2002

Department of Trade and Economic Development

Status of Prior Audit Issues As of December 20, 2001

Fiscal Year 2000 Statewide/Single Audit

We examined the department's activities and programs material to the *State of Minnesota's Comprehensive Annual Financial Report* for the fiscal year ended June 30, 2000. The purpose of the audit was to render an opinion on the State of Minnesota's financial statements for fiscal year 2000. We issued an unqualified opinion on the *State of Minnesota's Comprehensive Annual Financial Report* for the year ended June 30, 2000, and did not identify any financial statement findings or concerns as a result of our work at the Department of Trade and Economic Development.

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.

February 22, 2002

Mr James R. Nobles
Legislative Auditor
140 Centennial Building
658 Cedar Street
St. Paul, MN. 55155

Dear Mr. Nobles:

Thank you for the opportunity to review the draft management letter that summarizes recent audit work at the Department of Trade and Economic Development (DTED) for the year ended June 30, 2001. I appreciate the opportunity for my response to be released as part of the official audit. It will focus on the single finding and recommendations included in the audit.

1. The department did not accurately account for certain loans in the state's accounting system.

Recommendation: DTED should work with the Department of Finance (DOF) to correct the Rural Challenge Grant loan receivables balance in the state's accounting system.

Agency Response: DTED will work with DOF to adjust the Rural Challenge Grant loan receivables balance in the state's accounting system since these monies are now considered "grants" rather than "loans." DTED will no longer collect repayments from the loans made from these monies and this responsibility will be handled by the regional organizations administering the program locally. Work to complete this activity had been underway at the time of the audit. Future disbursements to the MN Initiative Funds will be coded as grants. Person responsible: Judy Kislenger; Projected completion date: Mid-March 2001.

Recommendation: The department should initiate clarification of Minn. Stat. Chapter 116J regarding the handling of Rural Challenge Grant loan principal and interest repayments at the regional level.

Agency Response: DTED will initiate housekeeping language to Minn. Stat. Chapter 116J, that governs the Rural Challenge Grant Program, to reflect current program operation and to clarify any ambiguous verbiage. Staff will work with the Attorney General's Office to prepare a housekeeping initiative for the FY2003 legislative session. Person responsible: Paul A. Moe

If you have additional questions, please call Bonnie Burt at (651) 297-1360.

Sincerely,

/s/ Rebecca Yanisch

Rebecca Yanisch
Commissioner

RY:bb