

Financial-Related Audit

**Minnesota State Colleges and
Universities
Northeast Service Unit
July 1, 1998, through 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.

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Northeast Higher Education District

Sally Thompson, Director
Northeast Service Unit

We have audited the Minnesota State Colleges and Universities' Northeast Service Unit for the period July 1, 1998, through June 30, 2001. Our audit scope included revenues, payroll, and other administrative expenditures. We highlight the audit objectives and conclusions in the individual chapters of this report.

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 require that we design the audit to provide reasonable assurance that the Northeast Service Unit complied with provisions of laws, regulations, contracts, and grants that are significant to the audit. Northeast Service Unit management is responsible for establishing and maintaining the internal control structure and complying with applicable laws, regulations, contracts, and grants.

This report is intended for the information of the Legislative Audit Commission, the management of the Northeast Service Unit, and members of the Minnesota State Colleges and Universities Board of Trustees. This restriction is not intended to limit the distribution of this report, which was released as a public document on June 7, 2002.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: March 22, 2002

Report Signed On: June 4, 2002

**Minnesota State Colleges and Universities
Northeast Service Unit**

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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
Carl Otto, CPA, CISA	Auditor-In-Charge
Patrick Phillips, CPA	Auditor

Exit Conference

We discussed the finding and recommendations with the following representatives of Northeast Service Unit and the Office of the Chancellor at the exit conference held on May 8, 2002:

Office of the Chancellor:

Laura King	Vice Chancellor/Chief Financial Officer
Margaret Jenniges	Director, Financial Reporting
John Asmussen	Executive Director, Internal Auditing
Kim McLaughlin	Regional Audit Coordinator
Jim Schneider	Director, Campus Accounting

Northeast Service Unit:

Joe Sertich	President, Northeast Higher Education District
Tony Bartovich	Director of Budget and Finance, Mesabi Range Community and Technical College

Minnesota State Colleges and Universities Northeast Service Unit

Report Summary

The Minnesota State Colleges and Universities' Northeast Service Unit (NESU) collected and accurately recorded campus support service fees in the accounting records. NESU properly charged the colleges for services rendered. NESU also accurately recorded payroll and administrative expenditures in the accounting records and complied with applicable legal provisions and management's authorization, except as noted below.

Key Finding and Recommendations:

NESU had inadequate controls over procurement practices and monitoring of contract payments. Some vendors provided services before the preparation of a requisition or purchase order. MnSCU policy and statutory provisions require that NESU ensure it has sufficient funds in the accounting system before incurring an obligation. NESU also paid a vendor \$1,000 more than the \$8,000 contract amount. Neither NESU nor the program director was monitoring the total amount of payments made against the contract. Also, the vendor's invoices did not distinguish between services provided and travel expenses. We recommended that NESU improve control over its procurement and purchasing process by prohibiting staff from incurring obligations before an encumbrance of funds in the accounting system. We also recommended that NESU monitor payments to ensure that they do not exceed contract amounts and that vendors comply with contract provisions.

<p>The Minnesota State Colleges and Universities' Northeast Service Unit provides administrative services to Fond du Lac Tribal and Community College, Hibbing Community and Technical College, and the Northeast Higher Education District. NESU's services include institutional research, a database of library materials, and grant administration. This financial-related audit report focused on revenue, payroll, and other administrative expenditures for the period from July 1, 1998, through June 30, 2001. NESU's response is included in the report.</p>
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Minnesota State Colleges and Universities Northeast Service Unit

Chapter 1. Introduction

The Minnesota State Colleges and Universities' Northeast Service Unit (NESU) provides support services to colleges located in northeastern Minnesota. NESU began in 1981 when the Arrowhead Community College Region (part of the now defunct Minnesota State Community College Board) consolidated certain management functions for community colleges in northeastern Minnesota. NESU provided accounts payable, human resources, purchasing, centralized maintenance supervision, and grant management services. When the Minnesota State Colleges and Universities (MnSCU) system began operations on July 1, 1995, it consolidated many community and technical colleges in northeastern Minnesota and, in 1998, it discontinued executive positions in the Arrowhead Region. The MnSCU board did recommend, however, that NESU continue to provide some support services to the northeastern colleges.

Ms. Sally Thompson has been the director of NESU since 1998. She reports to the presidents of the colleges NESU serves. The scope of services NESU provides to the colleges has changed in recent years. NESU currently provides institutional research, maintains a database of library materials, and administers grant programs and other contracted services. During fiscal year 2001, NESU provided services to the following colleges:

- Fond du Lac Tribal and Community College (Cloquet)
- Hibbing Community and Technical College (Hibbing)
- Northeast Higher Education District:
 - Itasca Community College (Grand Rapids)
 - Mesabi Range Community and Technical College (Eveleth and Virginia)
 - Rainy River Community College (International Falls)
 - Vermilion Community College (Ely)

NESU administered a \$250,000 Operating and Maintenance Loan Fund and a \$200,000 Repair and Betterment Loan Fund. These funds originated when NESU served colleges in the Arrowhead Community College Region. At June 30, 2001, the only loan outstanding was a \$150,000 loan to Itasca Community College.

NESU also processed transactions for the Northeast Alliance for Telecommunications (NEAT), which is a consortium of northeastern Minnesota higher education institutions formed to develop telecommunications technology for the delivery of instruction. NEAT received grants from the Higher Education Services Office and the Higher Education Telecommunications Council.

NESU also administered the Upward Bound Program. Upward Bound conducts a six-week summer academic residential session that offers pre-collegiate programs, emphasizing math, science, English/writing, and a second language component. Upward Bound received federal funding. NESU included NEAT and Upward Bound employees in its payroll roster.

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Chapter 2. Revenues

Chapter Conclusion

The Northeast Service Unit's internal controls provided reasonable assurance that it collected and accurately recorded campus support service fees in the accounting records. NESU properly charged the colleges for services rendered.

The Northeast Service Unit (NESU) charged the participating colleges for the support services it provided. The director developed an operating budget and allocated costs to colleges based on the services used and estimated student enrollment data. NESU billed the colleges 75 percent of budgeted costs at the beginning of the fiscal year. At the close of the fiscal year, NESU calculated the final bill using final enrollment data. Table 2-1 shows the fees charged and received from the participating colleges during fiscal year 2001.

**Table 2-1
Campus Support Service Fees
Fiscal Year 2001**

	<u>Fees</u>
Fond du Lac Tribal and Community College	\$ 18,335
Hibbing Community and Technical College	21,948
Northeast Higher Education District:	
Itasca Community College	20,896
Mesabi Range Community and Technical College	22,617
Rainy River Community College	17,028
Vermilion Community College	<u>19,485</u>
Total	<u>\$120,309</u>

Source: MnSCU accounting system.

Audit Objectives and Methodology

We focused on the following objectives during our review of revenue:

- Did NESU's internal controls provide reasonable assurance that it collected and accurately recorded campus support service fees in the accounting records?
- Did NESU properly charge the colleges for services rendered?

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To address these objectives, we interviewed NESU staff to gain an understanding of the receipt process and the basis used to establish campus support service fees. We also performed analytical procedures to determine and evaluate changes in revenues during the audit period.

Conclusions

The Northeast Service Unit's internal controls provided reasonable assurance that it collected and accurately recorded campus support service fees in the accounting records. NESU properly charged the colleges for services rendered.

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Chapter 3. Payroll and Other Administrative Expenditures

Chapter Conclusion

Northeast Service Unit's internal controls provided reasonable assurance that it accurately recorded payroll and administrative expenditures in the accounting records, and that it complied with applicable legal provisions and management's authorization. However, NESU had some inadequate controls over procurement practices and monitoring of contract payments

The Northeast Service Unit's (NESU) administrative expenditures totaled approximately \$706,000 during fiscal year 2001. Payroll was the largest administrative expenditure category totaling approximately \$546,000. Other administrative expenditure categories include purchased services, consultant/contract services, student activities, and supplies. Table 3-1 summarizes NESU's payroll and other administrative expenditures for fiscal year 2001.

**Table 3-1
Northeast Service Unit
Administrative Expenditures
Fiscal Year 2001**

	Northeast Service Unit	Northeast Alliance for Telecommunications	Upward Bound
Employee Salaries and Fringe Benefits	\$189,624	\$191,166	\$165,400
Salary Related Expenses	15,225	302	513
Purchased Services	7,545	0	2,981
Consultant/Contract Services	2,312	1,880	4,097
Supplies	7,760	300	22,553
Travel	9,996	6,349	3,946
Financial Aid	0	0	13,571
Indirect Costs	0	0	15,450
Student Activity Expenses	1,631	0	36,565
Other	<u>2,677</u>	<u>0</u>	<u>4,533</u>
Total Expenditures	<u>\$236,770</u>	<u>\$199,997</u>	<u>\$269,609</u>

Source: Minnesota Accounting and Procurement System and the MnSCU accounting system.

NESU's staff has declined from ten employees in fiscal year 1998 to five employees in fiscal year 2002. In addition, NEAT and Upward Bound employees are paid through NESU. NESU employees belong to various compensation plans, including the American Federation of State,

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County, and Municipal Employees, the Minnesota Association of Professional Employees, and the Middle Management Association. Hibbing Community College processes the payroll for NESU employees.

NESU spent approximately \$160,000 for purchased services, consultant/contract services, student activities, and supplies during fiscal year 2001. The NESU director initiated and/or approved all expenditures related to NESU operations, including institutional research, the online library database, regional customized training, and the NEAT grant. NESU prepared purchase orders and made payments for the Upward Bound Program based on the approval of the grant director.

Audit Objectives and Methodology

We focused our review of payroll and other administrative expenditures on the following objectives:

- Did NESU design and implement internal controls to provide reasonable assurance that it accurately recorded payroll and other administrative expenditures in the accounting records, and that it complied with applicable legal provisions and management's authorization?
- For the items tested, did NESU comply, in all material respects, with significant finance-related legal provisions concerning payroll and other administrative expenditures?

We interviewed NESU staff to gain an understanding of the payroll and other administrative expenditure procedures. We performed analytical procedures for administrative expenditures to evaluate any trends in specific account classes throughout the audit period. We also reviewed a sample of expenditure transactions to determine if NESU staff properly authorized, processed, and recorded transactions in compliance with material finance-related legal provisions.

Conclusion

Northeast Service Unit's internal controls provided reasonable assurance that it accurately recorded payroll and other administrative expenditures in the accounting records, and that it complied with applicable legal provisions and management's authorization. However, as discussed in Finding 1, NESU had some inadequate controls over procurement practices and monitoring of contract payments.

1. NESU had some inadequate controls over procurement practices and monitoring of contract payments.

For 9 of 28 purchase transactions tested, vendors provided services before the preparation of a requisition or purchase order. For example, Upward Bound staff submitted a requisition in July 1999 for student meals for its two summer programs. However, the first summer program was during June 1999. Program directors should submit purchase requisitions to NESU before

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obtaining goods or services. MnSCU policy and statutory provisions require that NESU ensure it has sufficient funds in the accounting system before incurring an obligation.

NESU also paid a vendor \$1,000 more than the \$8,000 contract amount. NESU paid the vendor \$9,000 in four payments: three \$1,800 payments and a final payment of \$3,600. Neither NESU nor the program director was monitoring the total amount of payments made against the contract. Also, the contract specified that \$7,200 was for the vendor to develop and deliver certain training, and \$800 was for travel and subsistence expenses consistent with the state's Commissioner's Plan. The vendor's invoices did not distinguish between services provided and travel expenses. Before making payments NESU should ensure that total payments do not exceed the contract amount and that vendors comply with contract provisions.

Recommendations

- *NESU should improve control over its procurement and purchasing process by prohibiting staff from incurring obligations before an encumbrance of funds in the accounting system.*
- *NESU should monitor payments to ensure that payments do not exceed contract amounts and that vendors comply with contract provisions*

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**Status of Prior Audit Issues
As of March 22, 2002**

Most Recent Audits

College Audit

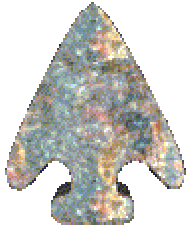
Legislative Audit Report 99-50, issued in September 1999, covered the former Arrowhead Community College Region and the Northeast Service Unit (NESU) for the three fiscal years ending June 30, 1998. The report reviewed service fee revenue, employee payroll, and other administrative expenditures. The report contained one finding: NESU did not properly report loan receivables on MnSCU accounting. NESU implemented our recommendation and now records loan receivables on the MnSCU accounting system.

Other Audit Coverage

The MnSCU Office of the Chancellor contracted with Deloitte and Touche, LLP, an independent CPA firm, to audit the MnSCU's general purpose financial statements and to report on its internal controls and compliance for its major federal programs. MnSCU received an unqualified opinion for fiscal year 2001. As a part of the audit, the firm issued a management letter to MnSCU's Board of Trustees. The letter contained 13 comments on accounting, administrative, and operating matters. The comments did not specifically mention MnSCU's Northeast Service Unit.

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. However, Finance has delegated this responsibility for audits of the Minnesota State Colleges and Universities (MnSCU) to the MnSCU Office of Internal Auditing. MnSCU's Office of Internal Auditing process consists of quarterly activity reports documenting the status of audit findings. The follow-up process continues until the Office of Internal Auditing is satisfied that the issues have been resolved.



NORTHEAST SERVICE UNIT
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May 15, 2002

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

Dear Mr. Nobles:

Thank you for the opportunity to respond to the recently completed audit report for the Northeast Service Unit for the period July 1, 1998, through June 30, 2001. During the period audited NESU acted as fiscal agent for a collaborative regional customized training program called the Northeast Training Unit (NETU). The director of this program and one clerical support staff member were located in an off-campus office with no access to MnSCU ISRS functions. NESU prepared purchase orders and processed disbursements with the NETU director's approval. Professional/technical contracts were prepared by NETU staff and attached to the encumbering documents, which were forwarded to NESU. The NETU program was eliminated and the office dismantled in March, 2000. In addition to NETU, NESU also provides fiscal services to the federal Upward Bound grant and the Northeast Alliance for Technology whose office are located respectively in Grand Rapids and Hibbing.

We were pleased to have had only one important audit finding and following is our response:

1. NESU had some inadequate controls over procurement practices and monitoring of contract payments.

We agree with the auditor's finding that NESU had inadequate controls over procurement practices and the monitoring of contract payments. In the example used, the NETU office prepared contracts and approved the invoices, but NESU made the payments; each thought the other was monitoring the total amount paid to the vendor. As fiscal agent, it was ultimately NESU's responsibility to make sure there was adequate contract coverage as well as encumbrance dollars. Because so many programs for which we provide fiscal services are located away from our office, it is sometimes difficult to establish encumbrances prior to a purchase. We plan to improve control over our current procurement and purchasing process by working with the program directors to make sure they understand MnSCU policy and statutory provisions. In addition, we will take full responsibility for the oversight of future contract payments to ensure they do not exceed the contract amount and that vendors comply with contract provisions in their invoicing procedures.

Person responsible: Sally Thompson
NESU Director

Implementation Date: Immediately

Please feel free to contact Sally Thompson at 218-748-2418 if there are any questions or concerns regarding this response.

Sincerely,

/s/ Joe Sertich

Dr. Joe Sertich
President, NHED