

Financial-Related Audit

**Minnesota Housing Finance
Agency**
July 1, 1997, through June 30, 2002



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



Senator Ann H. Rest, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Michael Finch, Chair
Minnesota Housing Finance Agency

Katherine G. Hadley, Commissioner
Minnesota Housing Finance Agency

We have audited the Minnesota Housing Finance Agency for the period July 1, 1997, through June 30, 2002. Our audit scope included: state appropriations, affordable rental investment fund, economic development and housing challenge programs, payroll, and other administrative expenditures. The audit objectives and conclusions are highlighted 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 Minnesota Housing Finance Agency complied with provisions of laws, regulations, contracts, and grants that are significant to the audit. The management of the Minnesota Housing Finance Agency 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 and the management of the Minnesota Housing Finance Agency. This restriction is not intended to limit the distribution of this report, which was released as a public document on September 6, 2002.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: July 12, 2002

Report Signed On: September 3, 2002

Minnesota Housing Finance Agency

Table of Contents

	Page
Report Summary	1
Chapter 1. Introduction	3
Chapter 2. State Appropriations	5
Chapter 3. Affordable Rental Investment Fund and Economic Development and Housing Challenge Programs	9
Chapter 4. Payroll and Employee Travel Reimbursements	11
Chapter 5. Administrative Expenditures	15
Status of Prior Audit Issues	17
Minnesota Housing Finance Agency Response	19

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
Connie Stein	Auditor
Kathy Fisher	Auditor

Exit Conference

The issues in this report were discussed with the following staff of the Minnesota Housing Finance Agency at an exit conference held on August 15, 2002:

Katherine Hadley	Commissioner
Patricia Hippe	Deputy Commissioner
William Kapphahn	Controller

Report Summary

Overall Conclusion

Except as noted below, for the selected areas audited, the Minnesota Housing Finance Agency properly safeguarded its assets and reasonably and prudently administered its financial activities. The Minnesota Housing Finance Agency's internal controls provided reasonable assurance that it administered its appropriations and administrative expenditures in compliance with applicable legal provisions and management's authorization. For the items tested, the agency complied with the significant legal provisions concerning state appropriations and administrative expenditures.

Current Findings and Recommendations

The agency did not protect the state's interests when it paid consulting firms to release employees from non-compete clauses. The agency paid \$61,000 to obtain the release of two employees from non-compete clauses with their former employers. The agency believed that the overall benefit of having in-house information technology staff and the long-term savings from reduced consulting costs outweighed the additional hiring costs resulting from the non-compete clause releases. We recommended steps the agency could take to ensure that the state's interests are better protected. (Finding 1, page 12)

The agency did not adequately monitor employees' access to the state's personnel/payroll system. A financial analyst, who did not have personnel or payroll responsibilities, had inappropriate access to update business expenses, adjust payroll data, and process retroactive payments. We recommended that the agency periodically review system access to ensure that it limits employees' access to the levels needed to perform their job responsibilities. (Finding 2, page 13)

Agency Background

In 1971 the state legislature created the Minnesota Housing Finance Agency (the agency) to increase the ability of low and moderate income Minnesotans to obtain safe, decent housing. Since that time, the agency has allocated funds to assist in the purchase, rehabilitation, and rental of housing by qualifying individuals. *Minnesota Statutes*, Chapter 462A, defines the agency's duties and responsibilities.

The Minnesota Housing Finance Agency funds its programs through a diverse combination of resources. Bond sales provide the majority of program funding. Other funds come from the federal government, state appropriations, and accumulated reserves.

Minnesota Housing Finance Agency

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Minnesota Housing Finance Agency

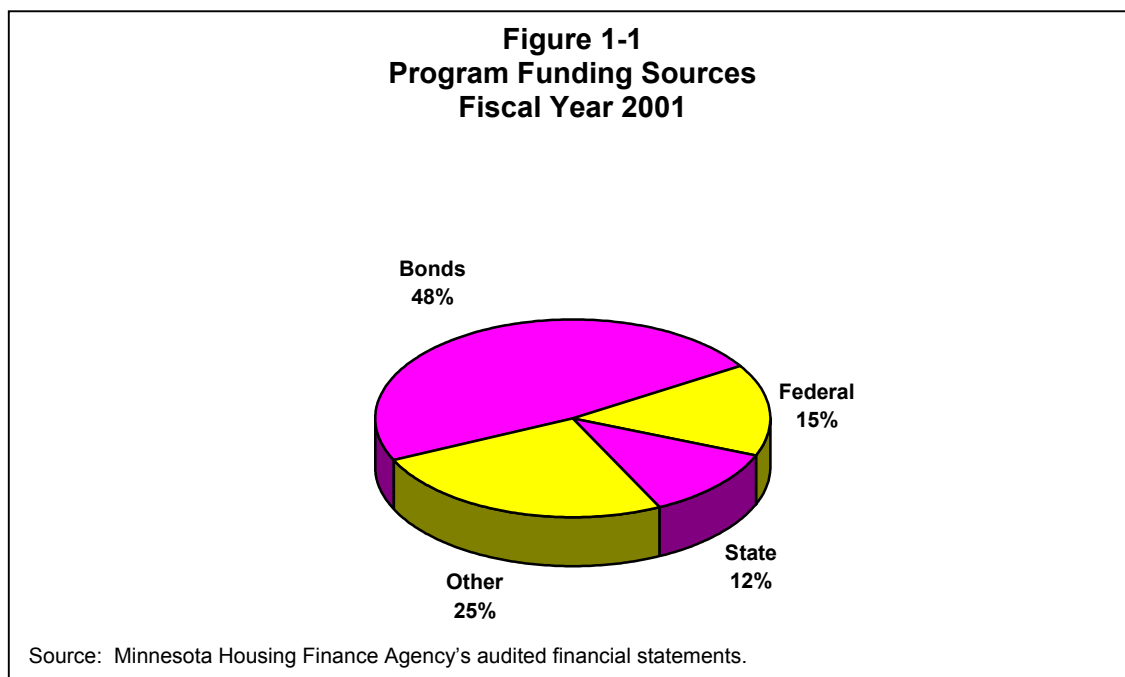
Chapter 1. Introduction

In 1971 the state Legislature created the Minnesota Housing Finance Agency (the agency) to increase the ability of low and moderate income Minnesotans to obtain safe, decent housing. The agency provides funds to assist in the purchase, rehabilitation, and rental of housing by qualifying individuals. *Minnesota Statutes*, Chapter 462A, defines the agency's duties and responsibilities.

The governing board of the agency consists of the commissioner of Trade and Economic Development, the State Auditor, and five public members appointed by the governor. The governor also appoints the agency's commissioner. Ms. Katherine Hadley has served as commissioner since July 1994.

The Minnesota Housing Finance Agency contracts with a certified public accounting firm to perform annual audits of its financial statements and federally funded programs. The objective of the financial audit is to determine if the agency has fairly presented its financial information in accordance with generally accepted accounting principles. The objective of the federal audit is to ensure compliance with federal regulations.

The Minnesota Housing Finance Agency funds its programs through a diverse combination of resources. Bond sales provide the majority of program funding. Other funds come from the federal government, state appropriations, and accumulated reserves. The agency prepares a biennial report, the Affordable Housing Plan, which sets forth their overall financing plan. Figure 1-1 shows the agency's program funding sources, as stated in the agency's audited financial statements for fiscal year 2001.



Minnesota Housing Finance Agency

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Chapter 2. State Appropriations

Chapter Conclusions

Minnesota Housing Finance Agency's internal controls provided reasonable assurance that it accurately reported its state appropriations in the accounting records and complied with applicable legal provisions and management's authorization.

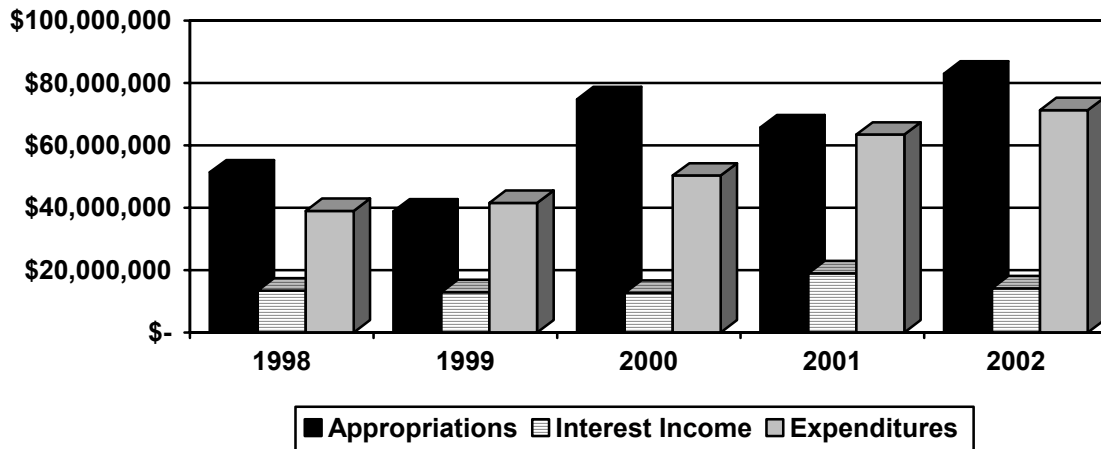
For the items tested, the agency complied, in all material respects, with the significant finance-related legal provisions concerning state appropriations.

The Minnesota Housing Finance Agency receives annual appropriations from the state legislature. The appropriation laws specify programs and funding for a variety of purposes, including low interest loans, deferred interest loans, rental assistance, rehabilitation programs, and other housing related program costs. The programs help low to moderate income persons and families achieve accessible and affordable housing. Statutory provisions allow the agency to carry over unexpended appropriations to future periods. The agency can also invest unspent appropriations and retain investment earnings, which it can use for the same purposes as the original appropriation and to cover the costs and expenses necessary and incidental to the development and operation of the programs. The agency invests unexpended appropriation dollars through the Minnesota State Board of Investment.

Figure 2-1 shows the total appropriations, interest income, and expenditures for fiscal years 1998 through 2002. The significant increases in appropriations since fiscal year 1998 have been due to a one time \$20 million appropriation for the Economic Development and Housing Challenge Program, discussed further in Chapter 3, and a reallocation of Temporary Assistance for Needy Families funding to provide housing assistance.

Minnesota Housing Finance Agency

**Figure 2-1
State Appropriations
Fiscal Years 1998 – 2002**



Note 1: Appropriations do not include unspent amounts carried over from prior fiscal years.

Note 2: The significant increases in appropriations since fiscal year 1998 have been due to a one time \$20 million appropriation for the Economic Development and Housing Challenge Program, discussed further in Chapter 3, and a reallocation of Temporary Assistance for Needy Families funding to provide housing assistance.

Source: Minnesota Accounting and Procurement System.

Audit Objectives and Methodology

Our review of the Minnesota Housing Finance Agency's state appropriations focused on the following questions:

- Did the agency's internal controls provide reasonable assurance that it accurately recorded state appropriations in the state accounting system and complied with applicable legal provisions and management's authorization?
- For the items tested, did the agency comply with material finance-related legal provisions concerning state appropriations?

To answer these questions, we interviewed agency personnel to gain an understanding of the internal control structure over state appropriation activity. We reviewed the process of recording appropriation activity, including interest income and overhead expenses, to determine if transactions were properly allocated and recorded. We also reviewed activity to determine if the agency complied with state policies and other material finance-related legal provisions. (Chapter 3 discusses the results of our more detailed testing of two specific appropriations.)

Minnesota Housing Finance Agency

Conclusions

The agency's internal controls provided reasonable assurance that it accurately reported state appropriations in the accounting records and complied with applicable legal provisions and management's authorization.

For the items tested, the agency complied, in all material respects, with the significant finance-related legal provisions concerning state appropriations.

Minnesota Housing Finance Agency

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Chapter 3. Affordable Rental Investment Fund and the Economic Development and Housing Challenge Programs

Chapter Conclusions

Minnesota Housing Finance Agency's internal controls provided reasonable assurance that it accurately recorded Affordable Rental Investment Fund and Economic Development and Housing Challenge Programs' disbursements in the accounting records and complied with applicable legal provisions and management's authorization.

For the items tested, the agency complied, in all material respects, with the significant finance-related legal provisions concerning the Affordable Rental Investment Fund and the Economic Development and Housing Challenge Programs.

Affordable Rental Investment Fund

The Affordable Rental Investment Fund is one of the many multifamily programs administered by the Minnesota Housing Finance Agency. The Legislature created the program in 1994 to meet Minnesotans' needs for safe, decent, affordable housing and to build stronger communities. The program provides deferred loans to eligible developers to acquire, construct, or rehabilitate rental housing for low-income households. The agency provides funds to eligible developers biannually through a request for proposal process. The Affordable Rental Investment Fund had two subprograms: The Preservation Affordable Rental Investment Fund and the Minnesota Families Affordable Rental Investment Fund.

The Legislature appropriated \$24,611,000 for fiscal years 1998 and 1999, and \$57,986,000 for fiscal years 2000 and 2001. In 2001, the Legislature merged the Affordable Rental Investment Fund (excluding the subprograms) into the Economic Development and Housing Challenge Program.

Economic Development and Housing Challenge Program

The 1999 Legislature created the Economic Development and Housing Challenge Program to provide grants or loans for housing construction, acquisition, and rehabilitation through various financing options. Loans are usually interest free and repayments are typically deferred. The agency uses repaid loans for program purposes. The agency makes Challenge Program grants or loans to cities, private developers, non-profit organizations, or owners of housing, including individuals, for both multifamily and single family projects. The agency gives preference to

Minnesota Housing Finance Agency

proposals that support economic development or job creation activities. This program requires that 50 percent of the funds be leveraged from an area employer and either a unit of local government or a philanthropic, religious, or charitable organization.

In 2000, the Challenge Program received a one-time only appropriation of \$20 million. The 2001 Legislature consolidated a number of homeownership and multifamily development programs into the Challenge Program, making it one of the agency's three primary programs. The Legislature appropriated \$24 million for the Challenge Program for both homeownership and rental development projects for fiscal years 2002 and 2003.

The Minnesota Housing Finance Agency expended approximately \$11.6 million during fiscal year 2002 for the Economic Development and Housing Challenge Program.

Audit Objectives and Methodology

Our review of the Minnesota Housing Finance Agency's Affordable Rental Investment Fund and Economic Development and Housing Challenge Program expenditures focused on the following questions:

- Did the agency's internal controls provide reasonable assurance that it accurately recorded Affordable Rental Investment Fund and Economic Development and Housing Challenge program expenditures in the accounting records and complied with applicable legal provisions and management's authorization?
- Did the agency comply, in all material respects, with significant finance-related legal provisions concerning Affordable Rental Investment Fund and Economic Development and Housing Challenge Program expenditures?

To answer these questions, we interviewed agency personnel to gain an understanding of the internal control structure over the expenditure process. We reviewed a sample for each program to determine if the agency properly authorized, processed, and recorded expenditure transactions. We also reviewed expenditures to determine if the agency complied with state policies and other material finance-related legal provisions.

Conclusions

The agency's internal controls provided reasonable assurance that it accurately recorded Affordable Rental Investment Fund and Economic Development and Housing Challenge Program expenditures in the accounting records and complied with applicable legal provisions and management's authorization.

For the items tested, the agency complied, in all material respects, with the significant finance-related legal provisions concerning Affordable Rental Investment Fund and Economic Development and Housing Challenge Program expenditures.

Chapter 4. Payroll and Employee Travel Reimbursements

Chapter Conclusions

The Minnesota Housing Finance Agency's internal controls provided reasonable assurance that it accurately recorded payroll expenditures and travel expense reimbursements in the accounting system and complied with material finance-related provisions of employee contracts. However, the agency did not adequately monitor employees' access to the state's personnel/payroll system.

For the items tested, the agency accurately compensated its employees and reimbursed travel expenditures in compliance with material finance-related provisions of employee contracts. However, the agency did not adequately protect the state's interests when it paid consulting firms to release employees from non-compete clauses.

The Minnesota Housing Finance Agency has about 190 employees. For fiscal year 2002, payroll expenditures totaled approximately \$11.4 million and employee travel expenditures, whether reimbursed to employees or paid directly to travel service providers, totaled about \$187,000. Employees at the agency are members of the following compensation plans:

- Middle Management Association
- Minnesota Association of Professional Employees
- American Federation of State, County, and Municipal Employees
- Commissioner's Plan
- Managerial Plan

The agency's payroll office collected employees' timesheets for update in the state payroll system's mass time entry, and was responsible for ensuring proper recording of timesheet entries according to supervisor authorizations. The agency's accounting/finance department is responsible for ensuring proper recording of travel expenditure reimbursements in the state's accounting system.

Audit Objectives and Methodology

Our review of the Minnesota Housing Finance Agency's payroll and employee travel expenditures focused on the following questions:

Minnesota Housing Finance Agency

- Did the agency's internal controls provide reasonable assurance that it properly recorded payroll expenditures and travel expense reimbursements in the accounting system and complied with material finance-related provisions of employee contracts?
- For the items tested, did the agency accurately compensate its employees and reimburse for travel expenditures in compliance with material finance-related provisions of employee contracts?

To answer these questions, we interviewed agency personnel to gain an understanding of the internal control structure over the payroll and personnel process as well as the employee travel reimbursement process. We analyzed payroll expenditures to determine proper recording of payroll transactions, reviewed source documents to determine proper authorization, and tested salaries to ensure proper payment pursuant to contract provisions. We also tested employee travel expenditure reimbursements to determine reasonableness, proper authorization, and compliance with bargaining unit agreements.

Conclusions

The agency's internal controls provided reasonable assurance that it properly recorded payroll expenditures and travel expense reimbursements in the accounting system and complied with material finance-related provisions of employee contracts. However, as discussed in Finding 2, the agency did not adequately monitor employees' access to the state personnel/payroll system.

For the items tested, the agency accurately compensated its employees and reimbursed travel expenditures in compliance with material finance-related provisions of employee contracts. However, as discussed in Finding 1, the agency did not protect the state's interests when it paid consulting firms to release employees from non-compete clauses.

1. The Housing Finance Agency did not adequately protect the state's interests when it paid consulting firms to release employees from noncompete clauses.

The Housing Finance Agency paid \$61,000 to obtain the release of two employees from noncompete clauses in employment agreements with their former employers. The agency paid one consulting firm \$25,000 and the other consulting firm \$36,000. The employees were information technology professionals who had provided consulting services to the agency and had specific skills and knowledge of the agency's systems that was beneficial to the agency. The agency believed that the overall benefit of having in-house information technology staff and the long-term savings from reduced consulting costs outweighed the additional hiring costs resulting from the noncompete clause releases.

State agencies should be very cautious when considering hiring an employee that has entered into a noncompete clause. When noncompete clauses have been determined valid through legal proceedings, a third party that interferes with the noncompete agreement may be held liable for damages. Typically, an employer seeks to enforce noncompete clauses to prevent ex-employees from working for a competitor, unfairly taking the employer's clients, customers, or employees, or to stop the former employee from establishing or operating a business in direct or indirect

Minnesota Housing Finance Agency

competition against the former employer. The enforceability of noncompete clauses has not been clearly established and is a specialized area of legal practice. Some states have outlawed noncompete clauses, and other states, including Minnesota, determine the enforceability of these clauses on a case-by-case basis, considering the degree to which it infringes on the employee's right to work.

While the agency's payments to the consulting firms were intended to eliminate the risk of legal proceedings resulting from hiring these employees, they also provided the employees with a significant benefit, since they were now free to work for any other employers, without restriction. The state's various collective bargaining unit agreements may limit an agency's ability to recover a payment in cases where employment expectations are not met. Also, the agency did not have an agreement with either consulting firm that specified the consideration the state received for its payments.

In one case, agency personnel stated they were familiar with the consulting firm's standard employment agreement, which included a noncompete clause. However, the agency did not obtain a copy of the employee's specific agreement nor did it consult with the Office of the Attorney General regarding the enforceability of the noncompete clause and the risk of possible litigation. The agency paid the consulting firm based on an e-mail statement that it was the firm's policy to charge \$25,000 when a client hires an employee. In the second case, agency personnel stated they obtained a copy of the employee's agreement with the contractor and discussed the noncompete clause with the Office of the Attorney General. The employee signed an addendum to his employment agreement with the consulting firm, releasing him from the noncompete provision in consideration of a \$36,000 payment from the agency. The agency was not a party to that agreement. As of August 2002, both employees were still employed by the agency.

Recommendation

- *Prior to making any payment to release an employee from a noncompete clause, the agency should obtain a legal analysis from the Office of the Attorney General to determine the enforceability of the noncompete clause and the risk of possible litigation. If considered enforceable, the agency should work with the Office of the Attorney General to establish an agreement between the state and the contractor documenting the terms of the payment in exchange for the employee's release from the noncompete clause and eliminating the state's risk of liability.*

2. The agency did not adequately monitor employees' access to the state's personnel/payroll system.

A financial analyst, who did not have personnel or payroll responsibilities, had inappropriate access to update business expenses, adjust payroll data, and process retroactive payments. The agency's access request to the Department of Employee Relations asked for a more restricted access, but the Department of Employee Relations did not properly input the request. The agency did not review the Department of Employee Relations' biweekly security reports to

Minnesota Housing Finance Agency

verify that the access granted agreed with the access requested. When employees have access that is greater than is needed to perform job functions, there is an unnecessarily greater risk of unauthorized transactions occurring and going undetected.

Recommendation

- *The agency should periodically review system access reports to ensure that it limits employees' access to the levels needed to perform their job responsibilities.*

Chapter 5. Administrative Expenditures

Chapter Conclusions

Minnesota Housing Finance Agency's internal controls provided reasonable assurance that it accurately recorded administrative disbursement transactions in the accounting records and complied with applicable legal provisions and management's authorization.

For the items tested, the agency complied, in all material respects, with the significant finance-related legal provisions concerning administrative expenditures.

The Minnesota Housing Finance Agency spent approximately \$6.5 million during fiscal year 2002 on administrative expenditures. The agency's departments initiated purchase requests and submitted them to the accounting department for processing. The accounting department ordered the goods and services, following state guidelines to solicit bids and select vendors. Upon receipt of the goods or services, the accounting department matched the invoice and the requisition before processing payment. Table 5-1 shows a breakdown of the agency's material non-payroll administrative expenditures during the audit period.

**Table 5-1
Administrative Expenditures
Fiscal Year 2002**

Professional Technical Services	\$2,446,720
Fixed Charges	1,768,124
Rent	1,000,692
Communications	233,314
Supplies	379,853
Statewide Indirect Costs	185,175
Equipment	59,023
Computer and Systems Services	135,916
Other Expenditures	<u>314,971</u>
Total Administrative Expenditures	<u>\$6,523,788</u>

Source: Minnesota Accounting and Procurement System.

Audit Objectives and Methodology

Our review of the Minnesota Housing Finance Agency's administrative expenditures focused on the following questions:

Minnesota Housing Finance Agency

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

To answer these questions, we interviewed agency personnel to gain an understanding of the internal control structure over the expenditure process. We reviewed a sample to determine if the agency properly authorized, processed, and recorded these administrative expenditure transactions. We also reviewed expenditures to determine if the agency complied with state policies and other material finance-related legal provisions.

Conclusions

The agency's internal controls provided reasonable assurance that it accurately recorded its administrative expenditures in the accounting records and complied with applicable legal provisions and management's authorization. For the items tested, the agency complied, in all material respects, with the significant finance-related legal provisions concerning administrative expenditures.

Status of Prior Audit Issues
As of July 12, 2002

Legislative Audit Report 98-41, issued in July 1998, covered fiscal years 1996 through 1997. The audit scope included aspects of the Affordable Rental Investment Fund Program, payroll, and other administrative expenditures. The audit report contained one finding concerning an inadequate separation of duties over the payroll process. The Minnesota Housing Finance Agency implemented this prior recommendation.

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 related 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 the Minnesota Housing Finance Agency, most other 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.

Minnesota Housing Finance Agency

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August 29, 2002

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

Dear Mr. Nobles:

The following comments are in response to the Office of the Legislative Auditor's (OLA) recent audit of the Minnesota Housing Finance Agency for the period July 1, 1997 through June 30, 2002. We understand that our responses will be incorporated into your final audit report.

1. The Housing Finance Agency did not adequately protect the state's interests when it paid consulting firms to release employees from noncompete clauses.

The Housing Finance Agency paid \$61,000 to obtain the release of two employees from noncompete clauses in employment agreements with their former employers. The agency paid one consulting firm \$25,000 and the other consulting firm \$36,000. The employees were information technology professionals who had provided consulting services to the agency and had specific skills and knowledge of the agency's systems that was beneficial to the agency. The agency believed that the overall benefit of having in-house information technology staff and the long-term savings from reduced consulting costs outweighed the additional hiring costs resulting from the noncompete clause releases.

State agencies should be very cautious when considering hiring an employee that has entered into a noncompete clause. When noncompete clauses have been determined valid through legal proceedings, a third party that interferes with the noncompete agreement may be held liable for damages. Typically, an employer seeks to enforce noncompete clauses to prevent ex-employees from working for a competitor, unfairly taking the employer's clients, customers, or employees, or to stop the former employee from establishing or operating a business in direct or indirect competition against the former employer. The enforceability of noncompete clauses has not been clearly established and is

a specialized area of legal practice. Some states have outlawed noncompete clauses, and other states, including Minnesota, determine the enforceability of these clauses on a case-by-case basis, considering the degree to which it infringes on the employee's right to work.

While the agency's payments to the consulting firms were intended to eliminate the risk of legal proceedings resulting from hiring these employees, they also provided the employees with a significant benefit, since they were now free to work for any other employers, without restriction. The state's various collective bargaining unit agreements may limit an agency's ability to recover a payment in cases where employment expectations are not met. Also, the agency did not have an agreement with either consulting firm that specified the consideration the state received for its payments.

In one case, agency personnel stated they were familiar with the consulting firm's standard employment agreement, which included a noncompete clause. However, the agency did not obtain a copy of the employee's specific agreement nor did it consult with the Office of the Attorney General regarding the enforceability of the noncompete clause and the risk of possible litigation. The agency paid the consulting firm based on an e-mail statement that it was the firm's policy to charge \$25,000 when a client hires an employee. In the second case, agency personnel stated they obtained a copy of the employee's agreement with the contractor and discussed the noncompete clause with the Office of the Attorney General. The employee signed an addendum to his employment agreement with the consulting firm, releasing him from the noncompete provision in consideration of a \$36,000 payment from the agency. The agency was not a party to that agreement. As of August 2002, both employees were still employed by the agency.

Recommendation

- *Prior to making any payment to release an employee from a noncompete clause, the agency should obtain a legal analysis from the Office of the Attorney General to determine the enforceability of the noncompete clause and the risk of possible litigation. If considered enforceable, the agency should work with the Office of the Attorney General to establish an agreement between the state and the contractor documenting the terms of the payment in exchange for the employee's release from the noncompete clause and eliminating the state's risk of liability.*

Management's Response

MHFA agrees that caution should be exercised in hiring employees who are subject to noncompete contracts with other employers. The OLA's report underscores the fact that hires of this type are relatively new to the state and that appropriate approaches to such hires are evolving. The following information is provided to demonstrate that MHFA used reasonable care in hiring the two employees referenced in your report, both of whom were subject to noncompete contracts with their employers, and that MHFA followed the limited advice available at the time, including advice from the Office of the Attorney General (AG),

Department of Administration and the Department of Employee Relations (DOER). In the event there are future hires of this kind, MHFA will inquire of the AG about the advisability of establishing the type of agreement recommended by the OLA in its report.

When the first such hire was contemplated by MHFA, we contacted the Department of Administration and DOER to determine whether the state had a protocol for hires that involved the payment of fees. Both departments were very helpful but the extent of their advice at that time was to confirm that such state hires were indeed occurring in the information technology field, that fees were being paid for such hires, either in the form of contract release fees or finder's fees, that a rational and defensible case needed to exist for pursuing such a hire and that agencies should strive to negotiate for the lowest fee possible. Further, the MHFA followed the Multi-Source Recruitment and Selection process, used by all state agencies, to hire for both IS positions. This process includes the basic principles of public notice, recruitment, interviewing and selection.

MHFA followed the limited advice available at that time. MHFA's Information Technology (IT) Strategic Plan called for the replacement by permanent state employees of key IT positions then held by contractors. Contractors held key IT positions at MHFA because of the difficulty at that time of attracting higher-paid IT professionals to state employment. The first hire involving a fee was for our Applications Development Manager. Significant cost savings were achieved in the first year alone by recruiting the consultant into state employment. Because MHFA regularly worked with the candidate's consulting firm, we were aware that the employment contract between the consultant and their firm contemplated possible hire by a client and that a standard fee was described but we asked that the firm confirm in writing their fee policy. Confirmation was received by e-mail from the firm's account manager. MHFA regularly accepts e-mail as an acceptable form of written communication between outside parties and itself as long as the e-mail is from a person authorized to represent the party and original signatures are not required.

When MHFA began to contemplate a second hire involving a fee, this time for our IT Director, we contacted both the Department of Administration, which offered no new guidelines than they previously had, and the AG. We felt the involvement of the AG was merited with this hire because the employment contract between the consultant and the firm did not contemplate the possibility of client hire. The AG advised us that the consultant's noncompete clause was enforceable but at no time did they advise us to become a party to any contract amendment that might ensue. The AG's advice was not provided to us in writing. Based on their advice, we approached the firm and inquired about their willingness to amend their employment contract with the consultant to allow for hire by MHFA. They indicated their willingness in exchange for a fee of 30% of the consultant's base salary. As with the earlier hire, this transaction made economic sense for MHFA and was consistent with its IT Strategic Plan. Furthermore, since a full recruiting campaign was waged, we can attest that most of the other viable candidates for this position were also represented by placement firms that required an equivalent fee for locating and placing a candidate with us. The cost of the fee paid was recovered in less than a year by the savings from employing the Director rather than contracting for the position.

Person responsible for resolving finding: Patricia Hippe, Deputy Commissioner

Date by which finding will be resolved: Since there is no action possible or recommended with respect to the two completed hires, the recommended action applies only to future hires, should they occur.

2. The agency did not adequately monitor employees' access to the state's personnel/payroll system.

A financial analyst, who did not have personnel or payroll responsibilities, had inappropriate access to update business expenses, adjust payroll data, and process retroactive payments. The agency's access request to the Department of Employee Relations asked for a more restricted access, but the Department of Employee Relations did not properly input the request. The agency did not review the Department of Employee Relations' biweekly security reports to verify that the access granted agreed with the access requested. When employees have access that is greater than is needed to perform job functions, there is an unnecessarily greater risk of unauthorized transactions occurring and going undetected.

Recommendation

- *The agency should periodically review system access reports to ensure that it limits employees' access to the levels needed to perform their job responsibilities.*

Management's Response

MHFA staff will continue to monitor system access reports for appropriateness. Since all system access requests must go through MHFA's DDIR in our human resources department, security reports will be monitored each and every time an access change is submitted. Traditionally, MHFA has monitored security reports annually at DOER's request.

As the OLA observed, the Department of Employee Relations did improperly process MHFA's request for system access in the area of processing retroactive payments. The other privileges, in the areas of updating business expenses and adjusting payroll data, were examined following the OLA's finding and determined to be appropriate for the work assigned to the financial analyst. However, the need for the analyst to perform business expense corrections is infrequent enough that we decided to reduce the access to view-only and have other staff process such changes. MHFA's human resources department is tiny and management continues to find it appropriate to assign certain types and amounts of the work to other staff. The financial analyst in question routinely makes cost coding corrections, location corrections, and expense transfers between accounts consistent with the duties assigned him.

Office of the Legislative Auditor

August 29, 2002

Page 5

Person responsible for resolving finding: Patricia Hippe, Deputy Commissioner

Date by which finding will be resolved: Done on August 29, 2002

If you desire additional information or clarification for any of the findings, please contact me by phone at 651-297-3125 or by e-mail at patricia.hippe@state.mn.us.

Sincerely,

/s/ Patricia Hippe

Patricia Hippe
Deputy Commissioner

cc: Katherine Hadley
Mike LeVasseur
Bill Kapphahn
Judy Marder