



OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Special Review

Minnesota State Arts Board

Employee Payroll Misappropriation



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.

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OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

Representative Tim Wilkin, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Robert C. Booker, Executive Director
Minnesota State Arts Board

Members of the Minnesota State Arts Board

We have conducted a special review of fraudulent payroll transactions by the accountant of the Minnesota State Arts Board. The review was conducted at the request of board management in response to their concerns that the board's accountant had processed payroll transactions for more hours than he actually worked and had given himself an unauthorized lump-sum salary payment. In addition, because the accountant also entered grant and vendor payments, board management had concerns about the potential for other inappropriate transactions. Based on preliminary information received from the Minnesota State Arts Board, we decided to pursue matters further and issue a special report. The following Summary highlights our objectives and conclusions. We discuss the issues more fully in the following chapters of the report.

Pursuant to Minn. Stat. Section 3.975, we have referred this report to the offices of the Attorney General and the Ramsey County Attorney. The Attorney General has the responsibility to ensure the recovery of state funds and, in fulfilling that role, may negotiate the propriety of individual claims. The county attorney shall cause criminal proceedings to be instituted as the evidence may warrant.

This report is intended for the information of the Legislative Audit Commission and the management of the Minnesota State Arts Board. This restriction is not intended to limit the distribution of this report, which was released as a public document on September 12, 2003.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: August 15, 2003

Report Signed On: September 9, 2003

Special Review: Minnesota State Arts Board Employee Payroll Misappropriation

Table of Contents

	Page
Report Summary	1
Chapter 1. Introduction	3
Chapter 2. Payroll	5
Chapter 3. Board Financial Activities	9
Agency Response	11

Audit Participation

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

James Nobles	Legislative Auditor
Claudia Gudvangen, CPA	Deputy Legislative Auditor
Brad White, CPA, CISA	Audit Manager
Marla Conroy, CPA, CISA	Director of Investigations
Sonya Johnson, CPA	Investigator

Exit Conference

The report was discussed with the following representatives from the Minnesota State Arts Board at an exit conference held on September 3, 2003:

Robert Booker	Executive Director
James Dusso	Assistant Director
Gail Burke	Executive Aide/Human Resources Manager

Special Review: Minnesota State Arts Board Employee Payroll Misappropriation

Report Summary

We conducted a special review of payroll expenditures for the accountant of the Minnesota State Arts Board. The review was conducted at the request of board management in response to their concerns that the board's accountant had paid himself for hours not worked and had processed an unauthorized lump-sum salary payment in the state's payroll system. In addition, due to the accountant's role in entering grant and vendor payments, board management had concerns about the potential for other inappropriate payments.

Our objective in conducting this special review was to answer the following questions:

- Did the Minnesota State Arts Board accountant process and receive unearned and unauthorized compensation?
- Were any other improper or unusual financial transactions processed by the board's accountant?

Conclusions

The Minnesota State Arts Board accountant, who was responsible for entering the board's payroll transactions in the state's payroll system, fraudulently compensated himself \$3,258. The accountant entered 73 hours more than he actually worked and processed a lump-sum payment to himself that was not authorized by board management. Approximately \$1,042 of the erroneous compensation was charged to a federal program. The board had not implemented effective controls to identify inappropriate entry of hours worked or other unauthorized transactions. Had independent board staff verified input of payroll data each pay period, these discrepancies could have been detected earlier.

Based on our limited analysis and management's review of board financial activities, grantee and vendor payments appeared reasonable. However, we found that the board's accountant did not implement some key financial audit recommendations cited in previous audit reports. Specifically, \$14,260 was not returned to the state's General Fund and \$12,796 was not transferred into a special revenue fund account. In addition, the accountant did not draw federal cash monthly, as recommended in the prior audit. As of July 2003, the board had not drawn any federal cash for fiscal year 2003, and the federal program had a negative cash balance of \$544,000.

**Special Review: Minnesota State Arts Board
Employee Payroll Misappropriation**

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Special Review: Minnesota State Arts Board Employee Payroll Misappropriation

Chapter 1. Introduction

The Minnesota State Arts Board distributes state appropriated funds to Minnesota's 11 regional arts councils and administers several grant programs that provide aid for performing, visual, and literary arts activities. The board currently has 11 employees after recently laying off 8 staff, including its accountant.

We conducted a special review of compensation paid to the Minnesota State Arts Board accountant. The accountant entered the biweekly payroll transactions and processed payments to grant recipients and vendors. In July 2003, board management noted discrepancies between the hours reported on the employee's timesheets and the hours input and paid in the state's payroll system, State Employee Management System (SEMA4). In addition, the board identified an unauthorized lump-sum salary payment that was processed through the payroll system. In response to these concerns, we conducted a preliminary assessment and determined the issues warranted further review. The results of this work are reported in Chapter 2.

In addition, board management was concerned about the potential for financial problems in other areas because the accountant also processed grant and vendor payments. In response to these concerns, we analyzed the reasonableness of financial transactions and trends. We also reviewed whether the grant recipients and vendors were reasonable, as discussed in Chapter 3.

Objective and Methodology

Our objective in conducting this special review was to answer the following questions:

- Did the Minnesota State Arts Board accountant process and receive unearned and unauthorized compensation?
- Were any other improper or unusual transactions processed by the board's accountant?

In conducting this review, we discussed policies and procedures with Minnesota State Arts Board management. We examined payroll documentation for the period from July 2002 through early August 2003. We compared hours worked, as recorded on the employee's timesheets and approved by his supervisor, to hours recorded and paid through the payroll system. We also took sworn testimony from the accountant. In addition, we analyzed grant recipients and vendors paid by the board from July 2001 through July 2003. Our review, however, was not a complete audit of the Minnesota State Arts Board. The last complete audit of the board covered the period July 1, 1998, through June 30, 2001.

**Special Review: Minnesota State Arts Board
Employee Payroll Misappropriation**

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Special Review: Minnesota State Arts Board Employee Payroll Misappropriation

Chapter 2. Payroll

Chapter Conclusions

The Minnesota State Arts Board accountant, who was responsible for entering the board's payroll transactions in the state's payroll system, fraudulently compensated himself \$3,258. Between February and July 2003, the employee entered 73 hours more than he actually worked. In addition, on July 2, 2002, the accountant processed an unauthorized lump-sum salary payment to himself. Approximately \$1,042 of the erroneous compensation was charged to a grant from the National Endowment for the Arts (CFDA #45.025). The remainder was charged to the Board's General Fund appropriation.

Internal controls designed to identify inappropriate entry of hours worked and unauthorized payroll transactions did not function as intended. Had independent board staff verified input of payroll data each pay period, these discrepancies could have been detected earlier.

The Minnesota State Arts Board underwent significant budget reductions in fiscal year 2003, as did other state agencies. In an attempt to deal with a 61 percent reduction in its funding, the board laid off eight of its employees including its only accountant, Mr. Rick Jeanette. Layoff letters were sent to employees on June 23, 2003. The board planned to contract with the Department of Administration for accounting services.

For the pay period ending July 15, 2003, board management determined that the accountant entered 80 hours into SEMA4 even though he had only worked 43.5 hours, as reported on his timesheet. Board officials contacted the Department of Finance to reverse the original transaction and correctly process 43.5 hours of pay. The accountant had depleted nearly all of his accumulated vacation and sick leave balances.

Board management contacted the Office of the Legislative Auditor to investigate other payroll overstatements input by the accountant, as discussed in Finding 1.

- 1. The board's accountant entered hours he had not worked in the state's payroll system and processed an unauthorized lump-sum salary payment, resulting in \$3,258 of unearned and unauthorized compensation.**

The Minnesota State Arts Board's accountant fraudulently paid himself unearned compensation totaling \$3,258. The accountant, who entered the board's biweekly payroll transactions in SEMA4, processed 73 hours more than he actually worked, as reported on his timesheets and

Special Review: Minnesota State Arts Board Employee Payroll Misappropriation

approved by his supervisor. In addition, he entered an unauthorized retroactive lump-sum salary payment. Because of these fraudulent actions, the board terminated the employee effective August 5, 2003.

The accountant contended that he was eligible for transition leave. Minnesota State Arts Board employees were covered by the state's Commissioner's Plan. The plan offered transition leave to employees who received a notice of permanent layoff. The leave was limited to 160 hours, was at the appointing authority's discretion, and ended on the layoff date. Board management utilized leave slips to authorize time away from work for transition leave purposes, and employees were to separately record the leave on their timesheets. The accountant would enter transition hours into the payroll system along with regular hours worked. The accountant, who entered transition leave hours for others, did not have authorized transition leave slips for himself. In addition, board management told us that they had not authorized transition leave for the accountant.

In addition to the erroneous entry of hours, the accountant processed a retroactive lump-sum salary payment that was not approved by board management. He entered a \$1,498 lump-sum payment for pay period ending July 2, 2002. Board management provided us with a listing of individuals eligible for lump-sum adjustments or performance increases at that time. Management did not authorize an increase for the accountant.

Table 2-1 shows a breakdown by pay period of the unearned and unauthorized compensation.

Table 2-1
Unauthorized Compensation

<u>Pay Period Ending</u>	<u>Hours Per Timesheet</u>	<u>Hours Processed</u>	<u>Paid Hours Not Worked</u>	<u>Overpayment</u>
February 11, 2003	71¼	80	8 ¾	\$ 211
May 6, 2003	76	80	4	96
May 20, 2003	66 ¾	80	13 ¼	320
June 3, 2003	69	80	11	265
July 1, 2003	44	80	36	868
Overpaid Hours	327	400	73	<u>\$1,760</u>
July 2, 2002	Unauthorized Lump-sum Payment			<u>\$1,498</u>
Total Overpayment				<u>\$3,258</u>

Note: Amounts exclude overpayment of employer FICA taxes of \$236 and of employer-provided retirement of \$130.

Source: Auditor determined from State Arts Board's payroll records.

The amounts in Table 2-1 for the pay period ending July 1, 2003, include 32 hours not worked that the accountant charged to the board's National Endowment for the Arts (CFDA #45.025) grant. The inappropriate charge totaled \$1,042 (\$772 of compensation and \$270 of fringe benefits). The federal grant provides administrative funding for the board. However, federal cost principles prohibit charges to federal programs when no relative benefit has been received.

Special Review: Minnesota State Arts Board Employee Payroll Misappropriation

The board will have to return this portion of the overpaid compensation and fringe benefits to the federal government.

Internal controls designed to detect erroneous entry of timesheet hours or unauthorized transactions include an independent review of the SEMA4 output reports. SEMA4 Operating Policy and Procedure PAY0028 requires that agencies review the payroll register to ensure accuracy of payroll input. The board did not implement this control practice. Had independent board staff verified input of payroll data each pay period, these discrepancies could have been detected earlier.

Recommendations

- *The Minnesota State Arts Board should work with the Office of the Attorney General to recover overpayments of \$3,258 made to the accountant.*
- *The board should reimburse \$1,042 of inappropriate salary and fringe benefit costs funded from the federal National Endowment for the Arts program.*
- *The board should improve internal controls by ensuring that each pay period staff independent of the input process compare the SEMA4 payroll register to timesheets and other documents authorizing special payroll transactions.*

**Special Review: Minnesota State Arts Board
Employee Payroll Misappropriation**

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Special Review: Minnesota State Arts Board Employee Payroll Misappropriation

Chapter 3. Board Financial Activities

Chapter Conclusions

Based on our limited analysis and management's review of board financial activities, grantee and vendor payments appeared reasonable. Revenue and expenditure levels and trends were reasonable for board activities. Vendors and grantees receiving payments were appropriate for the organization.

However, we found that the Minnesota State Arts Board did not implement some key financial audit recommendations cited in previous audit reports. The board's accountant was delegated responsibility for ensuring that these recommendations were implemented. Specifically, the accountant did not return \$14,260 to the state's General Fund, nor did he transfer \$12,796 of special revenue funds, inappropriately deposited into the board's gift fund. In addition, the accountant did not draw federal cash monthly, as recommended in the prior audit. As of July 2003, the board had not yet drawn any federal cash for fiscal year 2003, and the federal program had a negative cash balance of \$544,000.

Due to the payroll irregularities surrounding the board accountant, management of the Minnesota State Arts Board raised concern about potential for problems in other financial areas. In response to these concerns, we analyzed the financial transactions recorded in the state treasury for any unusual revenue or expenditure trends or vendors. We also compared grant recipients to those approved and listed on the board's website. These reviews revealed nothing unusual.

A recent audit of the Minnesota State Arts Board, Legislative Audit Report 02-40, issued in June 2002, identified some key financial concerns that the board's accountant was responsible for resolving. The June 2002 report cited two prior issues that were repeated from an earlier report issued in October 1998. The findings related to the inappropriate accounting for certain deposits, as noted below:

- The board inappropriately deposited \$14,260 of reimbursements and refunds into its gift fund. The moneys were received from a variety of sources, including grantees, vendors, or third parties. The amounts should have been deposited as expenditure reductions in the fund from which the original payment was made, typically the General Fund. Our current review found that the expenditure correcting entries was not done.
- The board inappropriately deposited \$12,796 of miscellaneous receipts into the agency's gift fund account. The board responded that it would set up a special revenue fund

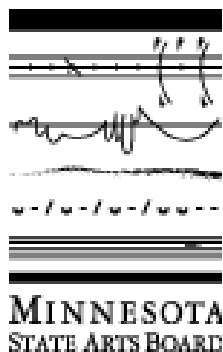
Special Review: Minnesota State Arts Board Employee Payroll Misappropriation

account and would transfer these funds into that account. The agency set up a special revenue fund account; however, it did not make the recommended transfer.

The board's accountant did establish a separate account in the gift fund for one grant, as recommended in the prior audit. The board received the first installment of \$366,000 during fiscal year 2001, and the funds were commingled with other moneys. However, the accountant did transfer the grant funds into a separate account on March 20, 2003. The board has recorded subsequent financial activity in this account, which will facilitate reporting back to the donor.

The 2002 audit also raised concerns about the board's cash management practices for its National Endowment for the Arts (NEA) grant. Sometimes excessive federal cash was requested in violation of federal cash management requirements and, at other times, too little was drawn causing dependence on state funds until the federal moneys arrived. In follow-up to these concerns, we found that the federal grant had a cash balance of approximately \$200,000 at the end of fiscal year 2002. As of July 31, 2003, the federal grant had a negative cash balance of \$544,000, and no federal cash had been drawn for the entire fiscal year. Both examples show that federal cash requests were not made to coincide with costs incurred.

Board management indicated to us that the accountant told them that all of the prior audit issues had been resolved. Board management was surprised by the substantial negative balance in the federal program account and made a subsequent request for federal funds. Management of the Minnesota State Arts Board is ultimately responsible for ensuring that all audit recommendations are appropriately resolved.



September 8, 2003

James R. Nobles
Legislative Auditor
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Office of the Legislative Auditor
140 Centennial Building
658 Cedar Street
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Dear Mr. Nobles:

Please consider this letter as the Arts Board management's response to findings contained in the special review conducted by your office over the past six weeks.

Let me first recognize and thank the members of your staff who carried out the audit, Brad White, Marla Conroy, and Sonya Johnson, for their professionalism, candor, and advice in working with the Arts Board staff.

As is noted in the report, when Arts Board management discovered discrepancies in our review of payroll reports we contacted your office. It was in response to that contact that the investigation was conducted and report generated. Also noted in the report is the concern that these discrepancies could have been detected sooner. You should know that these discrepancies came at a time when there was a change in the reporting process designed to identify such discrepancies. The reports changed from hard copies produced and distributed by the Department of Finance to electronic reports that the Arts Board was struggling to print out. We worked with the Department of Finance to correct this matter. At the same time, the Arts Board was focused on a significant reorganization all of its administrative functions, including accounting and payroll, caused by the 61 percent reduction in our state administrative funding.

Concerning the recommendations and conclusions in the report, the Board accepts those recommendations and has already instituted some new or changed procedures to address them. In addition, it will take whatever steps are necessary to comply with the recommendations.

Specifically:

- I, along with the Board's assistant director and its HR manager / executive aide, have met with a member of the Office of the Attorney General in regard to the items raised in the report as they relate to personnel issues, part of which may include recovery of the overpayments. In addition, appropriate Arts Board staff will

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Page two

- work with the Office of the Attorney General in any additional recovery actions that are taken.
- The Board's assistant director will work with the Department of Finance and the Department of Administration to restore inappropriately used federal funds by the end of the calendar year. The federal agency will be contacted regarding this issue and our plans to correct it.
- The Board's HR manager / executive aide and assistant director currently review payroll reports, as they are available, with timesheets and other authorizing documents. Unfortunately at this time, because of the limited staff size of the Arts Board, it is not possible to separate these oversight functions from the input processing.
- The Board's assistant director will work with the Department of Finance and the Department of Administration to address and rectify the \$14,260 of reimbursements and refunds and the \$12,796 of miscellaneous receipts inappropriately deposited into the Arts Board's gift account by the end of the calendar year.
- The Board has already rectified the \$544,000 negative federal funds cash balance identified in the report and a cash management plan, agreed upon by the Department of Finance and the Department of Administration, has been put in place.

I believe these actions address the concerns raised in the report to the extent possible, given the Arts Board's staffing and budget limitations.

Sincerely,

/s/ Robert C. Booker

Robert C. Booker
Executive Director

RCB/gb

cc: James A. Dusso, Assistant Director
Gail Burke, Human Resources Director / Executive Aide