



**FINANCIAL AUDIT DIVISION REPORT**

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**Department of Finance**  
**Federal Compliance Audit**  
**Year Ended June 30, 2008**

**March 26, 2009**

**Report 09-14**

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## OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

March 26, 2009

Senator Ann H. Rest, Chair  
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Tom J. Hanson, Commissioner  
Department of Finance

This report presents the results of our audit of the Department of Finance's responsibilities for the state's federal financial assistance programs, including general compliance requirements related to federal assistance, and the preparation of the *Minnesota Financial and Compliance Report of Federally Assisted Programs*, including the state's Schedule of Expenditures of Federal Awards for fiscal year 2008. We conducted this audit as part of our audit of the state's compliance with federal program requirements. We emphasize that this has not been a comprehensive audit of the Department of Finance.

We discussed the results of the audit with department staff at an exit conference on March 12, 2009. This audit was coordinated by Michael Hassing, CPA, CISA (Audit Manager).

This report is intended for the information and use of the Legislative Audit Commission and the management of the Department of Finance. This restriction is not intended to limit the distribution of this report, which was released as a public document on March 26, 2009.

We received the full cooperation of department staff while performing this audit.

*/s/ James R. Nobles*

James R. Nobles  
Legislative Auditor

*/s/ Cecile M. Ferkul*

Cecile M. Ferkul, CPA, CISA  
Deputy Legislative Auditor

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# Report Summary

## Conclusion

The Department of Finance generally complied with and had controls to ensure compliance with certain provisions of laws, regulations, contracts, and grants applicable to the state's administration of federal programs and the preparation of the *Financial and Compliance Report on Federally Assisted Programs* for fiscal year 2008. However, the state had a material weakness in its internal controls over subrecipient monitoring and had some deficiencies in its internal controls over the preparation of the Schedule of Expenditures of Federal Awards, as noted in the following *Findings and Recommendations* section.

## Findings

- The Department of Finance did not ensure that state agencies complied with federal requirements and state policy related to federal funds passed through to subrecipients. ([Finding 1, page 5](#))
- Prior Finding Partially Resolved: The state's procedures for preparing the Schedule of Expenditures of Federal Awards resulted in a significant audit adjustment and two errors to the draft schedules and impacted the determination of major programs to be audited under the Single Audit Act. ([Finding 2, page 6](#))

## Audit Objectives and Scope

The objective of our audit was to determine whether the Department of Finance complied with federal program requirements in its oversight and administration of the state's federal programs, including the general compliance requirements related to federal assistance and preparation of the Schedule of Expenditures of Federal Awards for fiscal year 2008. This audit is part of our broader federal Single Audit objective to obtain reasonable assurance about whether the State of Minnesota complied with the types of compliance requirements that are applicable to each of its federal programs.

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# Department of Finance

## Federal Program Overview

As the manager of the state's financial affairs, the Department of Finance<sup>1</sup> has high-level responsibility for the state's compliance with federal program requirements and has specific responsibility for some general federal compliance requirements, such as the determination of the state's indirect cost allocations to federal programs and cash management of federal funds. The department provides oversight to the other executive branch agencies related to statewide internal controls over the accounting, personnel and payroll, and procurement systems and establishes the appropriate policies for managing the state's financial resources, including federal program awards.

Each year, the department prepares the state's *Financial and Compliance Report on Federally Assisted Programs*, required as part of the state's Single Audit.<sup>2</sup> As a part of that report, the department prepares, with the assistance from other state agencies, the state's Schedule of Expenditures of Federal Awards for federal programs that we considered major federal programs for the State of Minnesota, subject to audit under the federal Single Audit Act.<sup>3</sup>

## Objectives, Scope, and Methodology

The objective of our audit was to determine whether the Department of Finance complied with federal program requirements in its oversight and administration of the state's federal programs, including the general compliance requirements related to federal assistance and preparation of the Schedule of Expenditures of Federal Awards for fiscal year 2008. This audit is part of our broader federal

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<sup>1</sup> Effective June 2008, the Legislature reorganized the Department of Finance to include the duties of the Department of Employee Relations. Although still identified in statute as the Department of Finance, in October 2008, the department changed its name to Minnesota Management and Budget. The department will seek legislative approval for the name change in the 2009 legislative session.

<sup>2</sup> The State of Minnesota's single audit is an entity audit of the state that includes both the financial statements and the expenditures of federal awards by all state agencies. We issued an unqualified audit opinion, dated December 9, 2008, on the State of Minnesota's basic financial statements for the year ended June 30, 2008. In accordance with *Government Auditing Standards*, we also issued our report, dated December 9, 2008, on our consideration of the State of Minnesota's internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts, and grants. (Office of the Legislative Auditor's Financial Audit Division [Report 09-03, Report on Internal Control Over Financial Reporting](#), issued February 13, 2009.) This report included control deficiencies related to the Department of Finance.

<sup>3</sup> We defined a major federal program for the State of Minnesota in accordance with a formula prescribed by the federal Office of Management and Budget as a program or cluster of programs whose expenditures for fiscal year 2008 exceeded \$23.8 million.

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Single Audit objective to obtain reasonable assurance about whether the State of Minnesota complied with the types of compliance requirements that are applicable to each of its federal programs.

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 the *Government Auditing Standards*, issued by the Comptroller General of the United States of America and with the U.S. Office of Management and Budget's *Circular A-133 Compliance Supplement*.

## **Conclusions**

The Department of Finance generally complied with and had controls to ensure compliance with certain provisions of laws, regulations, contracts, and grants applicable to the state's administration of federal programs and the preparation of the *Financial and Compliance Report on Federally Assisted Programs* for fiscal year 2008. However, the state had a material weakness in its internal controls over subrecipient monitoring and had some deficiencies in its internal controls over the preparation of the Schedule of Expenditures of Federal Awards, as noted in the following *Findings and Recommendations* section.

We have reported these control deficiencies to the federal government in the *Minnesota Financial and Compliance Report of Federally Assisted Programs*, prepared by the Department of Finance. This report provides the federal government with information about the state's use of federal funds and its compliance with federal program requirements. The report includes the results of our audit work, conclusions on the state's internal controls over and compliance with federal program requirements, including the preparation of the state's Schedules of Expenditures for Federal Awards, and our findings about control and compliance deficiencies with major federal programs administered by the State of Minnesota.

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# Findings and Recommendations

## Finding 1

**The Department of Finance did not ensure that state agencies complied with federal requirements and state policy related to federal funds passed through to subrecipients.**

In February 2009, we learned that the Department of Human Services had not appropriately notified counties that they were subrecipients of certain federal funds or identified the compliance requirements related to those funds, including the need for an audit under the Single Audit Act.<sup>4</sup> As a result, counties had not identified the expenditures of these funds as federal grant expenditures and their auditors did not include these expenditures in the scope of the counties' Single Audits. For some major federal programs, including the Medical Assistance Program (CFDA<sup>5</sup> 93.778), we estimate that counties omitted at least \$100 million of federal program expenditures from their Single Audit coverage.

The state's Medical Assistance Program is the largest federal program administered by the state. The Department of Human Service's failure to monitor the use of these federal funds by its subrecipients is a material weakness in the state's compliance with federal requirements. Audit tests at the Department of Education identified other federal pass-through funds that lacked proper notification to the subrecipients.

Based on federal regulations, the Department of Finance developed a policy to guide agencies in the proper administration of its federal funds, including their responsibilities when they passed federal funds through to subrecipients.<sup>6</sup> The department did not adequately communicate this policy to state agencies administering major federal programs and did not monitor whether those agencies complied with the policy's provisions.

### *Recommendation*

- *The Department of Finance should ensure that state agencies understand and comply with the federal and state requirements for federal funds passed through to subrecipients.*

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<sup>4</sup> United States Office of Management and Budget *Circular A-133*.

<sup>5</sup> The Catalog of Federal Domestic Assistance (CFDA) is a unique number assigned by the federal government to identify its programs.

<sup>6</sup> Department of Finance Policy 0402-03.

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## Finding 2

**Prior Finding Partially Resolved: The state's procedures for preparing the Schedule of Expenditures of Federal Awards resulted in a significant audit adjustment and two errors to the draft schedules and impacted the determination of major programs to be audited under the Single Audit Act.**

Although the Department of Finance improved its review of agency information used to prepare the state's Schedule of Expenditures of Federal Awards, the department continued to have errors in the fiscal year 2008 schedule that required audit adjustments. These errors had significant impact on the schedules and the state's overall major program materiality threshold. The department and the applicable agencies could have detected the errors by comparing variances in amounts between fiscal years and following up on significant differences.

The state's process to prepare the schedule requires extensive adjustments to the data produced by the state's accounting system. Finance relies on other departments, such as Human Services, Education, Health, Transportation, and Employment and Economic Development to provide federal expenditures, additional accruals or other adjustments that are not readily available in the state's accounting system or for programs outside the state's Federal Fund. The majority of the state's federal dollars are included in the Federal Fund; however, there are major federal programs outside the Federal Fund.

The Department of Finance and other agencies had the following errors related to the 2008 Schedule of Expenditures of Federal Awards:

- The departments of Finance and Employment and Economic Development did not make a \$26 million adjustment to the Schedule of Expenditures of Federal Awards, and a related footnote disclosure, for the Unemployment Insurance program (CFDA 17.225, with total expenditures of \$863 million) to agree with benefit expenses reported in the Unemployment Insurance financial statements. In addition, the Department of Finance made a posting error causing a \$984,000 overstatement of federal expenses for the Workforce Investment Act-Adult Programs (CFDA 17.258, with total expenditures of \$8 million).
  - The departments of Finance and Public Safety erroneously included \$3.8 million of state matching expenditures and \$466,590 of Hazard Mitigation Program (CFDA 97.039) expenditures in the schedule for the Disaster Recovery Public Assistance (CFDA 97.036, with total expenditures of \$22 million) program. After adjusting for this error, the Disaster Recovery Public Assistance Program no longer met the dollar threshold for a major federal program.
  - The Department of Health did not include \$2.5 million rebated to the Special Nutrition Program for Women, Infants and Children (CFDA 10.557, with total
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expenditures of \$93 million) for baby formula purchased in June 2008 on the Schedule of Expenditures of Federal Awards for fiscal year 2008. The Department of Finance had instructed the Department of Health not to make the adjustment because the adjustment had not been made when preparing the state's financial statements. Because of the different objectives and materiality for the federal expenditure schedules, the departments should make all adjustments necessary to achieve accurate reporting to the federal government.

- The Department of Finance should have required documentation to support the expenditure amounts submitted by the Department of Transportation. The Department of Transportation reported \$623.6 million of expenditures for the Highway Planning and Construction program (CFDA 20.205, with total expenditures of \$763 million) and \$61.3 million of expenditures for the Federal Transit Grant program (CFDA 20.500, with total expenditures of \$59 million) that represented federal reimbursements reported in the Trunk Highway Fund financial statements. The Department of Transportation historically reported federal reimbursements rather than expenditures because, consistent with state statute, the department deposits federal funds in the Trunk Highway Fund which also includes state funds<sup>7</sup>. However, the department did not reconcile amounts reported based on reimbursements to actual expenditures in the accounting system. Because the Transportation Department did not report its federal expenditures based on expenditure data in the state's accounting system and because of the significant increase in expenditures for the Federal Transit Grant, which had not been a major program in prior years, the Department of Finance should have investigated the reliability of the amounts reported by the Department of Transportation.

Finally, we were delayed in our determination of the state's major federal programs. The Department of Finance did not provide draft schedules to us until January 7, 2009, because it did not commit sufficient resources to the preparation of the draft Schedule of Expenditures until after it had completed the preparation of the state's financial statements. Errors in the schedules further delayed their finalization. The Single Audit Act requires that the state's major programs be determined based on the final schedules. Changes in the determination of major federal programs may result in the need for additional audit work before the state can issue its Financial and Compliance Report on Federally Assisted Programs, possibly risking its ability to issue the report by March 31, as required by the federal government.

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<sup>7</sup> *Minnesota Statutes* 2008, 161.04, subd. 1.

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*Recommendations*

- *The Department of Finance and applicable state agencies should:*
    - *ensure that they properly reflect expenditures and accruals in the draft federal expenditure schedules, and*
    - *enhance its analytical procedures to include non-Federal Fund activity.*
  - *Finance should require supporting documentation that reconciles expenditures to the accounting system when agencies report amounts based on federal reimbursements.*
  - *Finance should more promptly prepare the Schedule of Expenditures of Federal Awards to allow an earlier determination of major programs.*
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March 18, 2009

James R. Nobles, Legislative Auditor  
Office of the Legislative Auditor  
658 Cedar Street  
140 Centennial Office Building  
St. Paul, MN 55155-4708

Dear Mr. Nobles:

Thank you for the opportunity to discuss your audit findings with the individuals in your office responsible for the single audit. We are committed to providing to the federal government accurate financial information relating to the federally assisted programs. We will continue to work toward improvements in our processes and we do value suggestions which will make our existing process even stronger.

### **Finding**

Finding 1. The Department of Finance did not ensure that state agencies complied with federal requirements and state policy related to federal funds passed through to subrecipients.

### **Response**

State agencies should require subrecipients of federal financial assistance to complete audits in accordance with the Federal Office of Management and Budget (OMB) Circular A-133 and state policy. We plan to provide training on preparation of the Schedule of Expenditures of Federal Awards and we will incorporate a discussion on agencies' subrecipient responsibilities during the training. In addition, we will emphasize the importance of these subrecipient requirements to agencies in our annual correspondence requesting the Schedule of Expenditures of Federal Awards information.

Person Responsible: Barb Ruckheim, Financial Reporting Director

Implementation Date: November 30, 2009

### **Finding**

Finding 2. The state's procedures for preparing the Schedule of Expenditures of Federal Awards resulted in a significant audit adjustment and two errors to the draft schedules and impacted the determination of the major programs to be audited under the Single Audit Act.

## Response

We place a high priority on ensuring the accuracy of the Schedule of Expenditures of Federal Awards totaling \$7.9 billion for Fiscal Year 2008. During the past few years, significant improvements were made in the process used to capture federal expenditures reported in the Schedule of Expenditures of Federal Awards. As you noted, the majority of the federal expenditures are included in the Federal Fund. We developed an enhanced method of reconciling all data included in the state's Federal Fund to appropriate CFDA numbers, including verification of all accruals and other adjustments made to the state's accounting system to the amounts included in the state's annual financial statements for the Federal Fund. As a result of the reconciliation, we are able to provide much more detailed and accurate information to agencies for their review and certification. In addition, we performed a variance analysis by CFDA number comparing current year balances to the prior year for Federal Fund activity. We worked with agencies to obtain explanations for the variances and if applicable, necessary adjustments were made.

This issue arose primarily on federal programs that are not accounted for in the state's Federal Fund. These include the Unemployment Insurance program, Highway Planning and Construction program, and the Federal Transit Grant program. Federal programs are reported in funds other than the federal fund for several reasons, including law requiring a separate fund or generally accepted accounting principles requiring a different fund classification. For these Federal Awards reported outside the Federal Fund, we recognize additional procedures will further strengthen our process.

Federal expenditures for the Unemployment Insurance Program are recorded in a subsystem within the Department of Employment and Economic Development (DEED). Since this level of detail is not available in the statewide accounting system, the additional accruals and other adjustments must be reconciled to DEED's subsystem to obtain the amounts included in the Schedule of Expenditures of Federal Awards. In the future, we will include a list of these additional accruals and other adjustments with our request for the Schedule of Expenditures of Federal Awards.

Based on past practice, we made a decision not to reduce WIC (CFDA 10.557) expenditures for the June baby formula rebate. We have historically reported the Schedule of Expenditures of Federal Awards consistently with the state's financial statements unless amounts were significantly different. We will consider lowering our materiality threshold in the future.

As you noted, the Department of Transportation (MnDOT) prepares the Schedule of Expenditures of Federal Awards based on federal reimbursements rather than expenditures in the accounting system. MnDOT's subsystem tracks the detail expenditures being reimbursed by the federal government.

Although no adjustments were made to the Schedule of Expenditures of Federal Awards, we recognize improvements can strengthen this process by ensuring MnDOT prepares a reconciliation of the expenditure detail to the amounts included in the schedule submitted to us. In addition, we will reconcile this schedule to the related financial statements amounts for the Trunk Highway and Federal funds as applicable and investigate significant differences.

We will continue to work on improving the timing of the completion of the Schedule of Expenditures of Federal Awards. However, since the expenditures amounts are linked to the Federal Fund, we cannot complete our Single Audit expenditure schedules until the financial statement amounts are final. We recognize that the state's major program determination is based on the final schedule and the significant impact in the audit focus for changes to the major programs. In addition, we will continue to emphasize the importance of timely communication of material changes in programs from the prior year during the Single Audit training that we will provide to agencies.

Person Responsible: Barb Ruckheim, Financial Reporting Director

Implementation Date: March 31, 2010

Sincerely,

A handwritten signature in black ink that reads "Tom J. Hanson". The signature is written in a cursive style with a long horizontal flourish extending to the right.

Tom J. Hanson  
Commissioner