



FINANCIAL AUDIT DIVISION REPORT

Minnesota State Arts Board
Internal Control and Compliance Audit
July 1, 2007, through April 30, 2010

*The audit scope included money appropriated from the
Arts and Cultural Heritage Fund.*

August 12, 2010

Report 10-26

FINANCIAL AUDIT DIVISION

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OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

August 12, 2010

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Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Michael Charron, Chair
Minnesota State Arts Board

Members of the Minnesota State Arts Board

Ms. Susanne Gens, Executive Director
Minnesota State Arts Board

This report presents the results of our internal control and compliance audit of grants expended by the Minnesota State Arts Board for the period July 1, 2007, through April 30, 2010. The audit scope included money appropriated from the Arts and Cultural Heritage Fund.

We discussed the results of the audit with the Minnesota State Arts Board's staff on July 29, 2010. This audit was conducted by Brad White, CPA, CISA, CFE (Audit Manager) and Sonya Johnson, CPA, CFE (Auditor-in-Charge), assisted by Mark Allan, CPA, CFE (Senior Auditor).

This report is intended for the information and use 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 August 12, 2010.

We received the full cooperation of the Minnesota State Arts Board staff while performing this audit.

Handwritten signature of James R. Nobles in black ink.

James R. Nobles
Legislative Auditor

Handwritten signature of Cecile M. Ferkul in black ink.

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

Table of Contents

	<u>Page</u>
Report Summary	1
Agency Overview	3
Objectives, Scope, and Methodology	5
Conclusion	6
Findings and Recommendations	7
1. The Minnesota State Arts Board did not identify, document, and monitor its internal controls related to its grant expenditures	7
2. The Minnesota State Arts Board approved regional arts councils' use of money from the Arts and Cultural Heritage Fund for administrative costs although the law that appropriated the money did not clearly allow or prohibit the councils' use of money from the fund for administrative purposes	8
Agency Response.....	9

Report Summary

Conclusion

The Minnesota State Arts Board generally had adequate internal controls to ensure that it safeguarded its financial resources, accurately paid grantees in accordance with management authorizations, complied with finance-related legal provisions, and produced reliable financial data. For the items tested, the board generally complied with finance-related legal requirements. However, the board had not adequately assessed its internal control structure and needs to clarify finance-related legal requirements for its Arts and Cultural Heritage Fund grants. The board resolved three prior audit findings.

Findings

- The Minnesota State Arts Board did not identify, document, and monitor its internal controls related to its grant expenditures. ([Finding 1, page 7](#))
- The Minnesota State Arts Board approved regional arts councils' use of money from the Arts and Cultural Heritage Fund for administrative costs although the law that appropriated the money did not clearly allow or prohibit the councils' use of money from the fund for administrative purposes. ([Finding 2, page 8](#))

Audit Objectives and Scope

Objectives

- Internal Controls
- Legal Compliance

Period Audited

July 1, 2007, through April 30, 2010

Programs Audited

- Grants
-

Minnesota State Arts Board

Agency Overview

The Minnesota State Arts Board was established in 1975; the board operates under the authority of *Minnesota Statutes 2009*, Chapter 129D. The board consists of eleven citizens appointed by the Governor to serve four-year terms; eight members represent each of the state's congressional districts and three members are appointed at large. The board appointed Susanne Gens as the interim executive director in February 2008 and permanent executive director in February 2009.

The board received General Fund appropriations for administrative costs and grants and obtained federal funding from the National Endowment for the Arts. Beginning July 1, 2009, the board began to receive a significant new source of funding from the Arts and Cultural Heritage Fund. Resources for the fund were provided through a state constitutional amendment dedicating a portion of the state's sales tax revenue to the arts, arts education, and arts access to preserve Minnesota's history and cultural heritage. Other funding sources included contributions from private organizations and miscellaneous receipts.

The board awarded and disbursed state-funded grants for the following programs and purposes:

Regional Arts Councils - The board distributes funds to the 11 regional arts councils in Minnesota. The board allocates the portion of its legislative appropriations designated to the councils using a formula based on land area and populations reported in the 2000 census.

Institutional Support Program – This program provides unrestricted operating support to nonprofit, tax-exempt arts organizations that produce or exhibit works of art or offer a broad range of services to artists.

Other Grants – The board provides grants to individual artists and organizations through several programs, including Artist Assistance, Arts in Education, and other programs where presenters produce live public performances, exhibitions, or screenings in the visual, performing, and literary arts.

Table 1 summarizes the Minnesota State Arts Board grant expenditures for fiscal year 2009.

Table 1
Grant Expenditures by Recipient Type and Funding Source
July 1, 2008 through June 30, 2009

<u>Recipient Type</u>	<u>General Fund</u>	<u>Federal Fund</u>	<u>Gift Fund</u>
Nonprofit Arts Organizations	\$6,031,183	\$ 57,750	\$40,000
Regional Arts Councils	2,959,000	0	0
Individual Artists	353,850	266,150	0
Colleges and Universities	228,675	0	0
Schools	111,971	25,000	0
Cities and Towns	64,678	0	0
Totals	<u>\$9,749,357</u>	<u>\$348,900</u>	<u>\$40,000</u>

Source: Minnesota Accounting and Procurement System.

Table 2 summarizes the Minnesota State Arts Board grant expenditures for fiscal year 2010 (through April 30, 2010) which includes the additional resources the board received from the Arts and Cultural Heritage Fund.

Table 2
Grant Expenditures by Recipient Type and Funding Source
July 1, 2009 through April 30, 2010

<u>Recipient Type</u>	<u>General Fund</u>	<u>Federal Fund¹</u>	<u>Gift Fund</u>	<u>Arts & Cultural Heritage Fund</u>
Nonprofit Arts Organizations	\$4,658,521	\$373,246	\$38,254	\$ 6,437,331
Regional Arts Councils	2,458,000	13,000	0	6,330,000
Individual Artists	290,000	201,400	0	593,000
Colleges and Universities	240,807	0	1,746	366,058
Schools	50,000	73,018	0	0
Cities and Towns	21,290	0	0	30,425
Totals	<u>\$7,718,618</u>	<u>\$660,664</u>	<u>\$40,000</u>	<u>\$13,756,814</u>

¹In fiscal year 2010, the board received additional federal funding through the American Recovery and Reinvestment Act.

Source: Minnesota Accounting and Procurement System.

Objectives, Scope, and Methodology

Our selected-scope audit of the Minnesota State Arts Board's grants focused on the following audit objectives for the period of July 1, 2007, through April 30, 2010:

- Did the board have sufficient controls to ensure that it safeguarded its financial resources, accurately paid grantees in accordance with the board's authorizations, complied with finance-related legal provisions, and created reliable financial data?
- For the items selected for testing, did the board comply with grant contracts and finance-related legal requirements, as well as their own internal board policies?
- Did the board resolve prior audit findings?¹

To meet these objectives, we gained an understanding of the Minnesota State Arts Board's financial policies and procedures and *Minnesota Rules*, Chapter 1900, which set forth procedures and criteria to be followed by the board, advisory panels, and others for the grant process. We considered the risk of errors in the accounting records and potential noncompliance with relevant legal requirements. We analyzed accounting data to identify unusual trends or significant changes in financial operations. We examined samples of financial transactions and reviewed supporting documentation to test whether the board's controls were effective and if the transactions complied with laws, regulations, policies, and grant and contract provisions.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives.

We used the guidance contained in the *Internal Control-Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission.² We used state and federal laws, regulations, and contracts and policies and procedures established by the departments of Management and

¹ Office of the Legislative Auditor, Financial Audit Division, Report 06-14, *Minnesota State Arts Board*, issued May 24, 2006.

² The Treadway Commission and its Committee of Sponsoring Organizations were established in 1985 by the major national associations of accountants. One of their primary tasks was to identify the components of internal control that organizations should have in place to prevent inappropriate financial activity. The resulting *Internal Control-Integrated Framework* is the accepted accounting and auditing standard for internal control design and assessment.

Budget and Administration, and the Minnesota State Arts Board's internal policies and procedures as evaluation criteria for compliance.

Conclusion

The Minnesota State Arts Board generally had adequate internal controls to ensure that it safeguarded its financial resources, accurately paid grantees in accordance with management authorizations, complied with finance-related legal provisions, and produced reliable financial data. For the items tested, the board generally complied with finance-related legal requirements. However, the board had not adequately assessed its internal control structure and needs to clarify finance-related legal requirements for its Arts and Cultural Heritage Fund grants. The board resolved three prior audit findings.

The following *Findings and Recommendations* further explain the board's internal control and compliance weaknesses.

Findings and Recommendations

Finding 1

The Minnesota State Arts Board did not identify, document, and monitor its internal controls related to its grant expenditures.

The board did not have a comprehensive approach to the design of its internal controls over compliance with grant requirements. The board had an increased likelihood of control deficiencies, because it did not clearly document and communicate to all staff its risks, control activities, and monitoring policies and procedures. The board was aware of certain risks, had many control activities in place, and performed selected internal control monitoring functions. However, the board did not formally identify and analyze the risks, design its controls to address significant risks, or develop monitoring procedures to ensure the controls are in place and are effective to reduce the significant risks identified.

The board's funding sources have different criteria and compliance requirements. General Fund appropriations often contain specific grant requirements; federal funding has numerous grant criteria and compliance requirements; the new Arts and Cultural Heritage Fund has specific allowable uses. The board did not clearly assess whether its internal controls were sufficient to ensure that it used grant funds in compliance with the appropriate legal requirements. For example, the board did not verify that grantees acknowledged in their publications the grants received through the arts board, and the board did not design procedures to incorporate a reconciliation of granted funds to actual grantee expenditures for grants exceeding \$50,000, as required by state policy.³ If the board had performed a comprehensive risk assessment of its grant processes, it could have assessed the risk created by these examples, designed control procedures to address the significant risks, and monitored whether the controls were effective in reducing the risks to an acceptably low level.

State policy requires each agency head to identify, analyze, and manage business risks that impact an entity's ability to maintain its financial strength and the overall quality of its products and government services.⁴ This policy also requires communication of the internal control policies and procedures to all staff so they understand what is expected of them and the scope of their freedom to act. This policy also requires follow-up procedures that, at a minimum, should include ways to monitor results and report significant control deficiencies to individuals responsible for the process or activity involved, including executive management and those individuals in a position to take corrective action.

³ Department of Administration's Office of Grants Management Policy 08-08 and 08-10.

⁴ Department of Management and Budget Policy 0102-01.

Recommendation

- *The board should regularly review, clearly document, and communicate to staff its risks, control activities, and internal control monitoring functions for its key business processes.*

Finding 2

The Minnesota State Arts Board approved regional arts councils' use of money from the Arts and Cultural Heritage Fund for administrative costs although the law that appropriated the money did not clearly allow or prohibit the councils' use of money from the fund for administrative purposes.

The Minnesota State Arts Board approved 2010-2011 budgets for the regional arts councils that identified about \$817,400 in money from the Arts and Cultural Heritage Fund for the councils' administrative costs. The appropriation law that allocated money to the councils did not clearly allow or prohibit the use of money from the Arts and Cultural Heritage Fund for the councils' administrative costs.⁵

In contrast, the appropriation law explicitly authorized the Minnesota State Arts Board to use up to three percent of the total appropriation from the Arts and Cultural Heritage Fund for its administrative costs. The absence of similar language authorizing and limiting the councils' use of money from the Arts and Cultural Heritage Fund for administrative costs created uncertainty on an important concern. Use of money from the fund for administrative costs reduces the amount directly available for the arts programs the Legislature specifically funded.

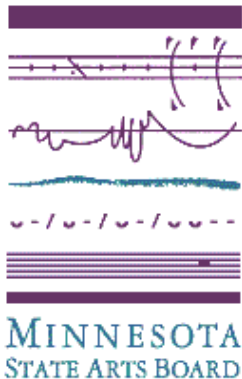
The Minnesota State Arts Board adopted a guideline indicating, "...it is vital to use the funds as effectively as possible and minimize administrative costs." However, according to the board's guideline, "The nonprofit standard is to keep administrative costs to 15 and 20 percent of overall expenses."⁶ This "standard" is significantly higher than the three percent the Legislature set for the Minnesota State Arts Board and further indicates a need for explicit language in law to authorize and limit the use of money from the Arts and Cultural Heritage Fund for regional arts councils' administrative costs.

Recommendation

- *The Minnesota State Arts Board should not approve the use of money from the Arts and Cultural Heritage Fund for the regional arts councils' administrative costs unless it has explicit authority in law.*

⁵ *Laws of Minnesota* 2009, Chapter 172, Article 4, Sec. 2, Subd. 2.

⁶ Regional arts councils' budgets approved for 2010-2011 included administrative costs ranging from 2 to 13 percent of their Arts and Cultural Heritage Fund allocation.



August 6, 2010

James Nobles, Legislative Auditor
Office of the Legislative Auditor
658 Cedar Street
Saint Paul, Minnesota 55155

Dear Mr. Nobles:

Thank you for the opportunity to respond to the internal control and compliance audit of grants expended by the Minnesota State Arts Board for the period July 1, 2007, through April 30, 2010.

We appreciate the time and careful attention members of your staff have given to understanding and carefully evaluating the grant making activities of the Minnesota State Arts Board. The board takes its role as steward of public funds very seriously and appreciates advice on how we can provide even better service to the state and its residents.

The following are the two findings contained in the report, and our responses to them:

Finding 1

The Minnesota State Arts Board did not identify, document, and monitor its internal controls related to its grant expenditures.

Recommendation

The board should regularly review, clearly document, and communicate to staff its risks, control activities, and internal control monitoring functions for its key business processes.

Response

The board agrees with this recommendation. As this report concludes, the board "generally had adequate internal controls to ensure that it safeguarded its financial resources, accurately paid grantees in accordance with management authorizations, complied with finance-related legal provisions, and produced reliable financial data."

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The board also recognizes that it can strengthen its internal control environment. It will use the tools provided by Minnesota Management and Budget's new Internal Control and Accountability unit to begin a comprehensive examination of its control environment, prioritize and document control procedures, and communicate them to staff as they are developed and updated. The board will conduct a grants management risk assessment and revise policies and procedures, as needed.

Person responsible

David White, director of finance and grants administration

Complete by

June 30, 2011

Finding 2

The Minnesota State Arts Board approved regional arts councils' use of money from the Arts and Cultural Heritage Fund for their administrative costs although the law that appropriated the money did not clearly allow or prohibit the councils' use of money from the fund for administrative purposes.

Recommendation

The Minnesota State Arts Board should not approve the use of money from the Arts and Cultural Heritage Fund for the regional arts councils' administrative costs unless it has explicit authority in law.

Response

The board accepts this finding and understands the importance of clarifying the legislature's intent regarding allowable costs.

For decades, the Arts Board has served as the fiscal agent for Minnesota's eleven regional arts councils. Each biennium, the board makes a block grant to each council; the funds must be used to implement the council's biennial plan which has been submitted to and approved by the board. The councils' biennial plans outline their intended grant making, direct services, technical assistance, and promotional efforts to stimulate the creation, performance, and appreciation of the arts in their geographic area of the state. The plans also outline the administrative costs that will be necessary to deliver these programs and services.

The Minnesota Charities Review Council has established accountability standards for nonprofit organizations. One of its financial standards is that "At least 65 percent of the nonprofit's three-year average annual expenses are used to directly support programming (ideal range is 70 to 90 percent)." Within this "ideal range," administrative costs of 10 to 30 percent would be reasonable.

However, the Arts Board has established a higher standard; its guidelines state that administrative costs should represent no more than 15 to 20 percent of a regional arts council's overall expenses. And, in fact, this audit report notes that the councils' actual administrative costs for the period under review fell below that range.

Councils are not state agencies, or divisions of state agencies. They are autonomous, nonprofit organizations that receive state block grants to help them address locally identified needs. They are responsible for managing public resources and, therefore, a reasonable level of administrative support is needed so that they can provide adequate stewardship for those funds. While the Arts Board cannot control what the legislature writes into law, it will encourage legislators to be more explicit about their intentions regarding allowable administrative costs.

Person responsible

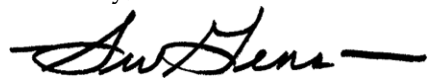
Sue Gens, executive director

Complete by

Conclusion 2011 legislative session

Thank you, again, for the opportunity to discuss these report findings with members of your staff and for this opportunity to respond. Please don't hesitate to contact me if there are additional questions or concerns.

Sincerely,



Susanne K. Gens
Executive Director
Minnesota State Arts Board

cc: David J. White, director of finance and grants administration
Michael J. Charron, chair, Minnesota State Arts Board