



**FINANCIAL AUDIT DIVISION REPORT**

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# **General Obligation Bond Expenditures**

## **Follow-up Review of 2008 Audit Recommendations**

**July 26, 2012**

**Report 12-14**

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FINANCIAL AUDIT DIVISION

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## OFFICE OF THE LEGISLATIVE AUDITOR

STATE OF MINNESOTA • James Nobles, Legislative Auditor

Date: July 26, 2012

To: Representative Michael Beard, Chair  
Legislative Audit Commission

Members of the Legislative Audit Commission

Members of the Senate Capital Investment Committee

Members of the House Capital Investment Committee

James Schowalter, Commissioner, Department of Management and Budget

Lee Ehmke, Director, Minnesota Zoo

Dr. Eric Kaler, President, University of Minnesota

From: James Nobles, Legislative Auditor  
Cecile Ferkul, Deputy Legislative Auditor

Subject: Follow-up Review of OLA's 2008 General Obligation Bond Expenditures Audit Report

The Office of the Legislative Auditor (OLA) recently completed a limited follow-up review of our 2008 audit of general obligation bond expenditures.<sup>1</sup> The objective of our review was to determine whether the Department of Management and Budget and other entities cited in the prior audit report implemented the prior audit recommendations.<sup>2</sup> OLA's review was conducted by Jim Riebe and Laura Wilson. During our review, we received full cooperation from the departments' staff.

To determine the status of the prior recommendations, we interviewed employees of the Department of Management and Budget and other agencies, reviewed revisions to applicable policies and procedures, training materials, and other supporting documentation, including capital project reports submitted to the Legislature and the Department of Administration and repayments of questioned costs. We did not test internal controls over general obligation bond expenditures or test whether the expenditures complied with finance-related legal provisions during this follow-up review. During 2013, we plan to conduct a comprehensive audit of the state's internal controls and compliance with finance-related legal provisions for general obligation bond expenditures.

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<sup>1</sup> Office of the Legislative Auditor's Financial Audit Division Report 08-34, *General Obligation Bond Expenditures*, issued December 5, 2008.

<sup>2</sup> Other entities cited in our prior audit report included the Minnesota Zoo, Minnesota State Colleges and Universities, University of Minnesota, Metropolitan Council, Minnesota Historical Society, Public Facilities Authority, departments of Education, Employment and Economic Development, and Transportation.

We concluded that the Department of Management and Budget and other entities cited in the prior report implemented recommendations related to two of the six findings and partially implemented recommendations for the other four findings. The following narrative cites the prior audit finding and the related recommendations and explains what was done to implement the recommendations.

**Finding 1 - The Department of Management and Budget did not sufficiently oversee projects funded with bond proceeds to ensure compliance with all legal requirements.**

*Recommendation – The Department of Management and Budget should verify the sufficiency of political subdivision matching funds, as required by state statute.*

**Recommendation Not Implemented:** Although the department continued to verify the local matching requirements specified in the bonding bills, it did not verify matching requirements contained in statute and grant agreements between state agencies and political subdivisions involving bond funds. Instead, it relied on state agencies to verify that political subdivisions met the matching requirements. State statutes require the commissioner of Management and Budget to determine the sufficiency of financial commitments from nonstate sources necessary to complete the projects before making capital appropriations available.<sup>3</sup>

*Recommendation – The Department of Management and Budget should develop a process to track property purchased or bettered with general obligation bond proceeds and ensure that entities file declarations with the applicable county to protect the state's interests.*

**Recommendation Partially Implemented:** Since the last audit, the department began requiring state agencies and other government entities that purchased property with state bond funds to provide photocopies of real estate declarations filed with the appropriate county.<sup>4</sup> However, because the department did not identify all purchases of property with general obligation debt proceeds (for example, by reviewing purchases recorded in the accounting system or capital project report summaries), it could not be sure whether entities filed declarations for all properties purchased. A real estate declaration protects the state's interest by preventing the subsequent sale of the property without the approval of the commissioner, as required by statute.<sup>5</sup> If the commissioner approves a sale of property purchased with bond funds, the statute further requires that the state use the proceeds of the sale to repay some or all of any outstanding related bonded debt.

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<sup>3</sup> *Minnesota Statutes* 2011, 16A.502.

<sup>4</sup> Third Order Amending the Order of the Commissioner of Finance Relating to Use and Sale of State Bond Financed Property, section 7.02. The revised order allows entities to request a waiver from filing a declaration when bond funds finance infrastructure that will not be sold in the future.

<sup>5</sup> *Minnesota Statutes* 2011, 16A.695.

*Recommendation – The Department of Management and Budget should monitor actual use of bond funds by reviewing financial activity recorded on the state's accounting system and/or requiring periodic and final accounting reports for each capital project. It should obtain sufficient documentation from entities not using the state's accounting system to ensure those entities' expenditures are appropriate uses of bond funds before reimbursing project costs.*

**Recommendation Partially Implemented:** Since our audit, the department has not consistently analyzed the bond expenditures recorded in the state's accounting system to ensure state agencies used the bond funds appropriately. In February 2010, in response to our prior report, the department hired an employee to review state agencies' and other government entities' bond fund expenditures. The employee completed reviews of the Department of Education, Historical Society, and Minnesota Zoo bond fund expenditures.<sup>6</sup> However, after the employee's resignation in November 2010, the department did not continue its review or analyze bond fund expenditures to identify potential ineligible uses. The department filled the vacant position in February 2012.

The department did not require entities that do not use the state's accounting system, such as the Metropolitan Council, Minnesota Historical Society, and the University of Minnesota, to provide financial data and/or accounting reports about their bond expenditures at a sufficient level of detail that assured the department the entities appropriately used the general obligation bond proceeds.<sup>7</sup> Instead, the department required authorized individuals from these entities to certify that the bond expenditures complied with finance-related legal requirements.

In July 2010, the department also began requiring these entities to certify obligations to be paid from bond funds and to provide evidence of the obligations (for example, grant agreements) prior to encumbering funds in the state's accounting system. However, it did not have a process to ensure it received the required information. For example, in July 2010, the Metropolitan Council did not certify obligations related to the 2006 through 2009 bonding bills. (In response to our inquiry, the Metropolitan Council certified its obligations related to those bond issues; the certified amount was \$144,000 less than the amount the Department of Management and Budget paid the council.)

*Recommendation – The Department of Management and Budget should provide better guidance to entities that grant bond funds to political subdivisions as to the level of fiscal monitoring required, and it should periodically review entity practices to ensure oversight agencies adequately monitor political subdivision grants.*

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<sup>6</sup> The employee started but did not complete bond fund transaction reviews of the departments of Administration and Transportation and the Minnesota State Colleges and Universities.

<sup>7</sup> The Department of Management and Budget has access to detailed, transaction level data related to bond expenditures made by state agencies that use the state's accounting system to process transactions; it does not have access to this information for entities that do not use the state's accounting system.

**Recommendation Implemented:** In the fall of 2010, the department conducted training on the use of general obligation bond proceeds for capital projects, and staff from state agencies and other government entities attended the training. As previously mentioned, the department hired an employee to monitor the state agencies and other entities' capital grants financial practices. The department also updated its capital grants manual and issued a formal memo, titled After the Bonding Bill, outlining the key general obligation bond legal requirements.

**Finding 2 - State agencies and other Minnesota government entities used approximately \$806,000 for project costs that were not appropriate uses of bond proceeds.**

*Recommendation – The Department of Management and Budget should update and expand its policies and procedures to clarify which costs can and cannot be paid with general obligation bond funds.*

**Recommendation Implemented:** The department updated its capital grants manual in March 2010. It also issued the After the Bonding Bill memo in March 2010 to commissioners and agency heads giving an overview of the key constitutional, statutory, and other legal requirements related to the use of general obligation proceeds.

*Recommendation – The Department of Management and Budget should work with the named entities to examine their accounting records for similar ineligible costs paid for from the 2006 bonding bill and pursue reimbursements to the general obligation bond appropriations from other funding sources for all ineligible costs.*

**Recommendation Partially Implemented:** As mentioned above, the department hired an employee to work with agencies cited in our prior report to determine the disposition of the ineligible costs and identify any additional ineligible costs. For example, for the Minnesota Zoo the employee identified an additional \$137,000 of ineligible costs related to the 2006 bonding bill. The employee also completed reviews at the Minnesota Historical Society and Department of Education before resigning; those reviews did not identify any additional ineligible costs.

As of May 2012, the department had not verified whether entities had reimbursed about \$663,000 of the \$806,000 of ineligible bond expenditures identified in the prior report and had not adequately resolved questions about the Minnesota Zoo's ineligible miscellaneous costs totaling about \$10,000 and the University of Minnesota's ineligible moving expenses totaling about \$32,000. The department had documentation to support reimbursements of bond funds totaling about \$101,000.



**Finding 3 - The Minnesota Zoo may not have complied with restrictions on bond funds designated for asset preservation for some expenditures and did not submit reports on asset preservation projects to the Legislature, as required by statute.**

*Recommendation – The Minnesota Zoo should work with the Department of Management and Budget and bond counsel to determine if it appropriately used asset preservation funds, or if it needs to reimburse its general obligation bond appropriation for the questionable amounts.*

**Recommendation Partially Implemented:** The Minnesota Zoo reimbursed \$107,000 of the \$689,000 bond expenditures questioned in the prior report, but continued to assert that the remaining \$591,000 (for a trail exhibit and holding pool) were appropriate uses of the asset preservation funds. However, the Department of Management and Budget and the Zoo did not seek an opinion from the bond counsel to determine whether the costs were appropriate uses of the general obligation proceeds or pursue other options to resolve these questioned costs, for example, getting input from the House and Senate Investment Committees.

*Recommendation – The Minnesota Zoo should comply with the reporting requirements for asset preservation funds and provide details about its use of these funds.*

**Recommendation Implemented:** We verified that the Minnesota Zoo submitted the annual asset preservation project reports to the Legislature in January 2011 and 2012, as required by statute.<sup>8</sup>

**Finding 4 - Some entities used bond funds for internal project management costs without clearly connecting those costs to authorized capital projects.**

*Recommendation – The Department of Management and Budget should formalize its policy about project management costs and require entities to provide assurance that those costs accurately represent time and materials spent on authorized capital projects.*

**Recommendation Implemented:** In October 2009, the department established a policy regarding the use of general obligation bond proceeds for payroll costs.<sup>9</sup> The policy requires entities to submit a plan to the department showing how the entity will track and report payroll costs paid for with bond funds. These entities must also submit quarterly payroll reports detailing the time used to implement capital projects.

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<sup>8</sup> Minnesota Statute 2011, 16B.307.

<sup>9</sup> Department of Management and Budget Policy Regarding Use of General Obligation Bond Proceeds to Fund Staff Costs, issued October 20, 2009.

**Finding 5 - The Minnesota State College and Universities' use of general obligation bond proceeds for the purchase and leaseback of a building may not comply with state constitutional and other legal requirements.**

*Recommendation – MnSCU should pay 95 percent of the revenues from the St. Cloud Technical College lease to the Department of Management and Budget in accordance with Minnesota Statutes 2007, 16A.695.*

**Recommendation Implemented:** MnSCU worked with the 2010 Legislature to pass a law that specified MnSCU must reimburse one-third of the lease revenue received from the property acquired for St. Cloud Technical College,<sup>10</sup> and MnSCU reimbursed the bond fund about \$343,000 based on the new law.

**Finding 6 - The University of Minnesota did not submit plans and project costs to the Legislature, as required by statute. Also, the Department of Education did not verify that information for one capital project was submitted by a school district to the Department of Administration or the Legislature for approval.**

*Recommendation – As required by statute, the University of Minnesota should submit program plans and cost estimates to the chairs of the House Ways and Means Committee and the Senate Finance Committee for approval.*

**Recommendation Not Implemented:** The University of Minnesota did not develop a process to ensure it submitted program plans and cost estimates to the chairs of the House Ways and Means Committee and the Senate Finance Committee for approval. The University could not provide evidence that it submitted the required information for all four capital projects we tested that received funds through the 2008 and 2010 bonding bills. Statutes require any entity that receives capital appropriations to submit program plans and cost estimates for all elements necessary to complete the project to the chairs of the Senate Finance and House Ways and Means committees.<sup>11</sup>

*Recommendation – The Department of Education should ensure that school districts submit predesign plans to the Department of Administration and plans and project costs to the Legislature for approval.*

**Recommendation Implemented:** The 2008 and 2010 bonding bills appropriated funds to one school district, and the Department of Education submitted the required information to the Department of Administration and Legislature.

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<sup>10</sup> *Minnesota Laws* 2010, Chapter 189, sec. 64.

<sup>11</sup> *Minnesota Statutes* 2011, 16B.335, subd. 1.

July 20, 2012

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

Dear Mr. Nobles:

We appreciate the opportunity to respond to your office's findings following your limited follow-up review of your 2008 audit of general obligation bond expenditures (Report 08-34). Except as otherwise noted below, our response will address only the 2008 recommendations for the findings related to Minnesota Management and Budget (MMB), which you indicated in your letter were not fully implemented.

**Finding 1** - The Department of Management and Budget did not sufficiently oversee projects funded with bond proceeds to ensure compliance with all legal requirements.

***Recommendations deemed not to have been fully implemented:***

- *The Department of Management and Budget should verify the sufficiency of political subdivision matching funds, as required by state statute.*
- *The Department of Management and Budget should develop a process to track property purchased or bettered with general obligation bond proceeds and ensure that entities file declarations with the applicable county to protect the state's interests.*

**Response:** To address these recommendations, in the 2012 version of our publication "[After the Bonding Bill](#)" which was distributed to agencies in June, we indicated that beginning on July 30, 2012, and on every July 30 thereafter, each agency receiving bond proceeds must file a report with MMB indicating the name of the grantee, grant amount and location for each project funded wholly or in part with state bond proceeds during the previous fiscal year, and the method used by the agency to determine whether the match and full project funding was in place. MMB will use these reports to verify that it has received the required recorded bond-financed property declarations and will also review projects on a sample selection basis to make sure that agencies are verifying match and full project funding.

- *The Department of Management and Budget should monitor actual use of bond funds by reviewing financial activity recorded on the state's accounting system and/or requiring*

*periodic and final accounting reports for each capital project. It should obtain sufficient documentation from entities not using the state's accounting system to ensure those entities' expenditures are appropriate uses of bond funds before reimbursing project costs.*

**Response:** As indicated in your letter, we have filled the position which reviews state agencies' and other government entities' bond fund expenditures. However, due to budget constraints, this position was combined with another vacant position before being filled. This employee will review such bond fund expenditures on a sample selection basis.

Starting in 2010, we have been requiring the Metropolitan Council, Minnesota Historical Society, and the University of Minnesota, all of which are not on the state's accounting system, to provide evidence that they have entered into commitments for bonding appropriations before we encumber those amounts in the accounting system.

In reference to the approximately \$144,000 which was spent by the Metropolitan Council from a 2006 appropriation in excess of the amount of obligations certified by the Council, we have begun working with bond counsel to determine to what extent such expenditures can be reimbursed from later bonding appropriations and will seek reimbursement to the state of any amounts that cannot be so reimbursed from later appropriations.

**Finding 2** - State agencies and other Minnesota government entities used approximately \$806,000 for project costs that were not appropriate uses of bond proceeds.

***Recommendation deemed not to have been fully implemented:***

- *The Department of Management and Budget should work with the named entities to examine their accounting records for similar ineligible costs paid for from the 2006 bonding bill and pursue reimbursements to the general obligation bond appropriations from other funding sources for all ineligible costs.*

**Response:** Agencies submitted documentation to us which they believed adequately substantiated their repayment of at least \$707,000 of the ineligible bond expenditures identified in the 2008 report and in your letter under this finding. We will work with all of the agencies cited to obtain the needed documentation to show that all eligible amounts have been repaid and will seek repayment of any amounts which have not yet been reimbursed.

We will also continue to conduct training workshops for state agencies as to the proper use of bonding proceeds and the appropriate oversight to be exercised by agencies with respect to monitoring grants and loans of state bond proceeds.

Some of the ineligible bond expenditures cited in the 2008 audit involved moving and relocation expenses. In view of your ongoing concern about the eligibility of these expenses and bond counsel's view that in most cases these expenses cannot be reimbursed from bond proceeds, in June we notified agencies that effective immediately, such expenditures are not to be paid from bond funds.

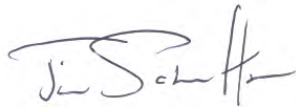
**Finding 3** - The Minnesota Zoo may not have complied with restrictions on bond funds designated for asset preservation for some expenditures and did not submit reports on asset preservation projects to the Legislature, as required by statute.

***Recommendation deemed not to have been fully implemented:***

- *The Minnesota Zoo should work with the Department of Management and Budget and bond counsel to determine if it appropriately used asset preservation funds, or if it needs to reimburse its general obligation bond appropriation for the questionable amounts.*

**Response:** We will work with the Minnesota Zoo to obtain advice from bond counsel as to whether the \$591,000 cited in the 2008 report spent on new construction and additional space for the Minnesota trail exhibit and for a new holding pool and surrounding area were appropriate uses of asset preservation funds and will seek reimbursement for amounts which bond counsel deems to have been improperly spent.

Sincerely,

A handwritten signature in black ink, appearing to read "James Schowalter". The signature is fluid and cursive, with the first name "James" and last name "Schowalter" clearly legible.

James Schowalter  
Commissioner





July 23, 2012

James R. Nobles, Legislative Auditor  
Office of the Legislative Auditor  
Room 140 Centennial Building  
658 Cedar Street  
St. Paul, MN 55155-1603

Dear Mr. Nobles:

Thank you for the opportunity to provide a response to your “Follow-up Review of OLA’s 2008 General Obligation Bond Expenditures Audit Report.”

We commit to working with Minnesota Management and Budget, as we have in the past, to resolve any outstanding issues.

Because this letter references findings in a report from several years ago, we believe it would be helpful to provide some context to the findings which mention the Minnesota Zoo:

Finding 2 indicates that Minnesota Management and Budget “had not adequately resolved questions about the Minnesota Zoo’s ineligible miscellaneous costs totaling about \$10,000....” Our original response, copied below, details our position that the approximately \$10,000 in expenses were appropriately charged. Our position on these expenditures has not changed.

**We disagree that some of the expenditures referenced in the audit are ineligible. For example, expenses related to the sea otters were necessary to “equip” the exhibit prior to opening. While we agree that replacing these would be an operating expense, the initial costs are not. The airfare that is referenced was for staff to look at a flooring product to determine whether it would meet our needs. Had this project been contracted out, those expenses would have been paid to a contractor.**

Finding 3 references a prior recommendation that had been partially implemented, but that the Zoo and Minnesota Management and Budget had not resolved remaining questioned costs. The Zoo and Minnesota Management and Budget did meet and discuss these costs, and the Zoo maintains our original position. Our response to the questions on these costs in the original audit is copied below:

**Under M.S. 16B.307, “The legislature assumes that many projects for preservation and replacement of portions of existing capital assets will constitute betterments and capital improvement within the meaning of the Constitution and capital expenditures under generally accepted accounting principles, and will be financed more efficiently and economically under this section than by direct appropriations for specific projects.” We believe that the costs associated with the rehabilitation of the Minnesota Trail meet this test. We have been forthcoming with both the Legislature and the Minnesota Management and Budget office not only regarding the Minnesota Trail project, but with all other projects funded with bonding dollars. We have met both with Administration staff and with Legislative committees during the conceptual process to present and discuss our needs and priorities. We have offered and provided tours both during and after construction. No aspects of our Asset Preservation projects were ever questioned throughout this process.**

**The “holding pool and surrounding area” are questioned as to whether they meet Asset Preservation guidelines. In fact, this project was undertaken within the area that formerly housed dolphins (and Beluga whales before that) prior to construction of Discovery Bay. This was an area that had been unused since the construction of Discovery Bay, but still contained many infrastructure elements necessary for supporting salt-water life support systems for marine mammals and other aquatic animals. With the addition of sea otters to the collection, this space provided an opportunity to create an animal holding area to be used, not only prior to the opening of Russia’s Grizzly Coast, but on an on-going basis. We believe this project meets the intent of the appropriation. Again, it should be noted that to have built an equivalent animal holding area “from scratch” would have required new capital expenditures of many hundreds of thousands of dollars, but by re-using existing building space and utility systems, the same end was accomplished for significantly less.**

Thank you for the opportunity to provide this background information on our position. Again, we are committed to working with Minnesota Management and Budget and the Legislature to resolve these issues.

Sincerely,



Lee C. Ehmke  
Director/CEO



*Twin Cities Campus*

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July 17, 2012

Jim Nobles, Legislative Auditor  
Office of the Legislative Auditor  
Room 140, Centennial Building  
658 Cedar Street  
St. Paul MN 55155-1603

Dear Mr. Nobles:

This letter is in response to the findings included in the Follow-up Review of OLA's 2008 General Obligation Bond Expenditures Audit Report that pertain to the University of Minnesota.

- **Audit Finding 6**

The University of Minnesota did not develop a process to ensure it submitted program plans and cost estimates to the chairs of the House Ways and Means Committee and the Senate Finance Committee for approval. The University could not provide evidence that it submitted the required information for all four capital projects we tested that received funds through the 2008 and 2010 bonding bills. Statutes require any entity that receives capital appropriations to submit program plans and cost estimates for all elements necessary to complete the project to the chairs of the Senate Finance and House Ways and Means committees.

University of Minnesota Response

The University agrees with this audit finding and has implemented new procedures to ensure that information is submitted to the legislature in accordance with 16B.335 Review of Plans and Projects. The Board of Regents' policy on Reservation and Delegation of Authority requires that the administration present to the Board of Regents the schematic design plans for projects with a value greater than \$2,000,000 that have an exterior visual impact and interior renovations with a value greater than \$5,000,000. For projects receiving a legislative appropriation that requires the submission of information under 16B.335 the University will send the required information to the committee chairs following the schematic design review by the Board of Regents.

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July 17, 2012  
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Thank you for your efforts and those of your dedicated staff.

Sincerely,



Richard Pfitzenreuter  
Vice President & CFO / Treasurer

cc: Eric Kaler, President  
Suzanne Smith, Assistant Vice President- Capital Planning & Project Management  
Brian Swanson, Assistant Vice President- University Services Finance  
Gail Klatt, Associate Vice President – Audits  
James Schowalter, Commissioner, Minnesota Management and Budget