



FINANCIAL AUDIT DIVISION REPORT

Perpich Center for Arts Education

Internal Controls and Compliance Audit

July 1, 2009, through June 30, 2011

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

August 30, 2012

Report 12-18

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OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

August 30, 2012

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Susan Mackert, Executive Director
Perpich Center for Arts Education

This report presents the results of our internal controls and compliance audit of selected financial activities of the Perpich Center for Arts Education for fiscal years 2010 and 2011.

We discussed the results of the audit with the Perpich Center for Arts Education's staff on August 15, 2012. This audit was conducted by Sonya Johnson, CPA, CFE (Audit Manager) and Susan Kachelmeyer, CPA, CISA (Auditor-in-Charge), assisted by auditors Cathy Patterson, Kathy Rootham, Emily Wiant, and Heather Varez.

We received the full cooperation of the Perpich Center for Arts Education's staff while performing this audit.

James R. Nobles
Legislative Auditor

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

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Report Summary

Conclusion

Internal controls were generally adequate to ensure that the Perpich Center for Arts Education (center) safeguarded its financial resources, accurately paid employees and vendors in accordance with management's authorizations, produced reliable financial data, and complied with finance-related legal requirements, including those associated with the use of money from the Arts and Cultural Heritage Fund; however, the center did not have adequate internal controls for financial activity related to student fee receipts and capital assets.

For the items tested, the center generally complied with finance-related legal requirements, including those associated with the use of money from the Arts and Cultural Heritage Fund; however, the center had some instances of noncompliance related to receipts, capital assets, and payroll.

The center resolved 13 out of 17 prior audit findings.¹ The center did not resolve four prior audit findings related to internal controls for receipts (including access to its computerized business systems), its overall financial management responsibilities, and the relationship with its foundation.

Key Findings

- Prior Finding Not Resolved: The Perpich Center for Arts Education had fundamental internal control weaknesses in its processes to collect, deposit, and accurately record receipts of student fees. ([Finding 1, page 7](#))
- The Perpich Center for Arts Education did not have adequate internal controls over its capital asset inventory and purchases. ([Finding 2, page 11](#))
- Prior Finding Partially Resolved: The Perpich Center for Arts Education did not adequately assess its financial risks or monitor the effectiveness of its internal controls. ([Finding 3, page 12](#))

Audit Objectives and Scope

Objectives

- Internal controls
- Finance-related legal compliance

Period Audited

Fiscal years 2010 and 2011

¹ Office of the Legislative Auditor's Financial Division Report 08-24, *Perpich Center for Arts Education*, issued October 9, 2008.

Programs Audited

- Student fees and other selected receipts
 - Payroll and other selected administrative expenditures
 - Capital assets
 - Foundation relationship
 - Use of money from the Arts and Cultural Heritage Fund
-

Perpich Center for Arts Education

Agency Overview

The Perpich Center for Arts Education (center) is an executive branch agency of the State of Minnesota. Its mission is to provide innovative public education services centered in the arts to Minnesota students and teachers in the K-12 system. The center operates a public residential arts high school for approximately 300 11th and 12th grade students who enroll from communities across the state. Approximately half of the student population resides in a dormitory on campus. The center also provides resources to educators and teaching artists throughout Minnesota to support and improve instructional practices in and through the arts and operates the Perpich Center for Arts Education Library, an information and resource center for students, faculty, staff, and the general public.

Minnesota Statutes 2011, Chapter 129C, provides the authority and responsibilities for the Perpich Center for Arts Education and its 15-member board of directors. Susan Mackert began her appointment as the center's executive director in February 2010.

For fiscal years 2010 and 2011, the center's primary source of funding was the state's General Fund; it received General Fund appropriations of \$7,087,000 each year. In addition, the center received appropriations from the Arts and Cultural Heritage Fund, one of the sales-tax supported Legacy Funds, of \$300,000 and \$700,000, respectively². Finally, the center collected other revenues, mainly in the form of student fees, totaling \$736,723 and \$520,945, respectively.

Table 1 summarizes the center's expenditures for fiscal years 2010 and 2011.

² In 2008, Minnesota voters approved the Outdoor Heritage, Clean Water, Parks and Trails, and Arts and Cultural Heritage Amendment to the Minnesota Constitution, commonly referred to as the "Legacy Amendment." The amendment increased the state sales tax by three-eighths of 1 percent for a 25-year period beginning July 2009 and distributed the taxes among the Outdoor Heritage, Clean Water, Parks and Trails, and Arts and Cultural Heritage funds, which are collectively referred to as the Legacy Funds. The Arts and Cultural Heritage Fund receives 19¾ percent of the dedicated sales tax revenue, which must be used for arts, arts education, arts access, and preservation of Minnesota's history and cultural heritage.

Table 1
Perpich Center for Arts Education
Expenditures
By Fiscal Year

<u>Expenditures</u>	<u>2010</u>	<u>2011</u>
Payroll	\$5,625,008	\$5,698,406
Professional/technical services	377,844	811,166
Supplies and equipment	523,769	564,374
Miscellaneous operating costs	442,732	412,320
Aids/grants to school districts	184,424	195,734
Other expenditures ¹	535,128	539,749
Travel	53,889	80,634
Total Expenditures	<u>\$7,742,794</u>	<u>\$8,302,383</u>

¹Other expenditures included rent, repairs and alterations, printing, computer and system services, communications, employee development, indirect costs, agency provided professional/technical services, and reimbursements to other state agencies.

Source: Minnesota Accounting and Procurement System.

The center used its appropriations of money from the Arts and Cultural Heritage Fund for the following projects:³

- The *Arts Education in Minnesota Schools Research Project* collected information from public and private schools to establish baseline data on arts education practices statewide.
- The *Arts Integration Project* used the information gathered by the *Arts Education in Minnesota Schools Research Project* to develop a program to train teachers how to integrate arts into the classroom.

Table 2 summarizes the expenditures for the center's Arts and Cultural Heritage Fund appropriation for fiscal years 2010 and 2011.

³ You can obtain more information about these projects at <http://www.legacy.leg.mn/projects>.

Table 2
Perpich Center for Arts Education
Expenditures of Money from the
Arts and Cultural Heritage Fund
By Fiscal Year

<u>Expenditures</u>	<u>2010</u>	<u>2011</u>
Payroll	\$ 67,101	\$209,080
Professional/technical services	87,789	469,326
Travel	3,827	14,740
Other expenditures ¹	<u>3,133</u>	<u>9,156</u>
Total	<u>\$161,850</u>	<u>\$702,302</u>

¹Other expenditures included operating costs, such as communications, supplies and equipment, and employee development.

Source: Minnesota Accounting and Procurement System.

Scope, Objective, and Methodology

Our audit examined the Perpich Center for Arts Education's material financial processes and those transactions we considered to be a higher risk of error or fraud if internal controls were deficient. We primarily examined fiscal years 2010 and 2011.⁴

The objective of our audit was to answer the following questions:

- Did the Perpich Center for Arts Education have adequate internal controls to ensure that it safeguarded its financial resources, accurately paid employees and vendors in accordance with management's authorizations, produced reliable financial data, and complied with finance-related legal provisions, including those associated with the Arts and Cultural Heritage Fund appropriations?
- Did the Perpich Center for Arts Education comply with applicable finance-related legal requirements, including those associated with the Arts and Cultural Heritage Fund appropriation?
- Did the Perpich Center for Arts Education resolve prior audit findings?

To answer these questions, we gained an understanding of the center's financial policies and procedures. We considered the risk of errors in the accounting records and noncompliance with relevant legal requirements. We analyzed accounting data to identify unusual trends or significant changes in financial operations. We examined samples of transactions and evidence supporting the

⁴ At the time of our audit, financial activity for fiscal year 2012 (with the exception of payroll transactions) was not readily available because of the state's implementation of a new accounting system in July 2011. Our audit examined fiscal year 2012 payroll transactions through December 2011, totaling about \$2.3 million.

center's internal controls and compliance with laws, regulations, policies, and contracts and expanded testing in areas where weak controls may have provided an opportunity for theft or fraud.

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 various criteria to evaluate internal controls and compliance. As our criteria to evaluate agency controls, we used the guidance contained in the *Internal Control-Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission.⁵ We used state and federal laws, regulations, and contracts, as well as state policies and procedures established by the departments of Administration and Management and Budget and the center's internal policies and procedures as criteria to assess compliance.

Conclusion

Internal controls were generally adequate to ensure that the Perpich Center for Arts Education (center) safeguarded its financial resources, accurately paid employees and vendors in accordance with management's authorizations, produced reliable financial data, and complied with finance-related legal requirements, including those associated with the use of money from the Arts and Cultural Heritage Fund; however, the center did not have adequate internal controls for financial activity related to student fee receipts and capital assets.

For the items tested, the center generally complied with finance-related legal requirements; however, the center had some instances of noncompliance related to receipts, capital assets, and payroll.

The center resolved 13 out of 17 prior audit findings.⁶ The center did not resolve four prior audit findings related to internal controls for receipts (including access to its computerized business systems), its overall financial management responsibilities, and the relationship with its foundation.

The following *Findings and Recommendations* further explain the center's internal control weaknesses and noncompliance concerns.

⁵ 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.

⁶ Office of the Legislative Auditor's Financial Division Report 08-24, *Perpich Center for Arts Education*, issued October 9, 2008.

Findings and Recommendations

Prior Finding Not Resolved: The Perpich Center for Arts Education had fundamental internal control weaknesses in its processes to collect, deposit, and accurately record receipts of student fees.

Finding 1

The center did not have adequate internal controls for its student fee receipts, which totaled approximately \$ 518,310 in fiscal year 2010 and \$432,552 in fiscal year 2011. The center's internal control deficiencies created an unacceptably high risk of error or fraud occurring for receipts without detection. The center had weaknesses in the following fundamental areas of internal control:

- **Lack of separation of incompatible duties** – The center did not separate incompatible duties within its receipt process. In general, it is considered a control weakness to assign the same person more than one of the following duties: 1) the custody of assets; 2) the authorization or approval of related transactions affecting those assets; and 3) the recording or reporting of related transactions. Separating these duties helps to ensure that no employee can both perpetrate and conceal errors or fraud in the normal course of their duties. State policy requires that agencies either separate key duties so that one employee is not in control of an entire process or establish effective mitigating controls.⁷

Since the summer of 2010, when a business office employee retired, one center employee performed a multitude of duties and had control of the entire receipts process. The employee had the following incompatible duties:

- Custody of the assets – she had direct access to receipts, prepared receipts for deposit, brought the receipts to the bank.
- Authority to complete or approve transactions – she prepared student fee invoices and statements, prepared accounts receivable schedules for management, reviewed and approved need-based fee reductions, charged parents' credit card accounts for some students on established payment plans, and requested and authorized student fee refunds.
- Recorded those transactions in the accounting records – she recorded receipts and credits in the center's student fee financial records, recorded deposits in the state's accounting system, and recorded those transactions in the receipt log.

⁷ Department of Management and Budget Policy 0602-03, *Recording and Depositing Receipts*.

In April 2011, the center instituted an internal control designed to mitigate the risk of error and fraud created by one person performing these duties; however, the design of the internal control was deficient because it relied on documentation created and controlled by the employee with the incompatible duties.

- **Incompatible and excessive access to electronic student account records** – The center did not adequately restrict employees' access to its electronic student account records. The employee with incompatible duties (discussed in the previous bullet) also had incompatible update access to the center's student account records. This access allowed her to record receipts, adjust accounts, and correct errors. She was also one of three employees who had update access to the center's student cafeteria account records which allowed her to increase or decrease account balances. All of the center's finance employees had access to update the internal receipt logs. The center did not periodically review employee access to ensure it limited access to the employee's assigned job responsibilities.

State policy requires agencies to limit employees' access privileges to functions that are essential to the position responsibilities, eliminate incompatible access, and review the access periodically.⁸ If the agency is unable to prevent incompatible access, state policy requires the agency to put in place effective mitigating controls. Incompatible or excessive access could allow unauthorized transactions to occur without detection.

- **Inadequate support for financial transactions** – The center did not retain sufficient documentation to support certain financial activity. The center had the following deficiencies in its documentation:
 - The center did not have records to show how it accounted for individual student fee receipts in fiscal year 2010. Although the state's accounting system recorded aggregated student fee receipt transactions, without detailed records, the center was unable to show that it had appropriately credited specific students' accounts. For fiscal year 2011, it did not have sufficient records or reports to support student fee transactions.
 - The center did not have documentation to show why it refunded student fees totaling \$22,422 in fiscal year 2010.
 - For 5 of 16 student accounts we tested for the 2010-2011 school year, the center's student account records showed credit transactions totaling \$4,091 that were not adequately substantiated by other documentation.

⁸ Department of Management and Budget Policy 1101-07, *Security and Access*.

- For some student fee receipts recorded on the receipt log, the center's supporting documentation did not include a form designed to document the reason the payment was to be distributed to the students' accounts. Without this distribution form, the center was unable to confirm the accurate posting of transactions to its student account records.
- **Lack of reconciliations** – The center had no evidence to show that it regularly reconciled its student fee documentation, such as daily logs or bank deposits, to its student account records. The center also did not reconcile its student account records to the financial transactions recorded in the state's accounting system.

Regular reconciliations performed by someone independent of the process is a critical control to ensure the accuracy and integrity of the accounting records. These reconciliations would have identified discrepancies between the center's student account records and the state's accounting system, and allowed management to make corrections and determine whether the discrepancies occurred due to error or fraud.

- **Lack of employee accountability for transactions** – In many cases, documentation available to support receipt transactions did not show who received, reviewed, authorized, or completed the transaction. Generally, receipt logs, distribution forms, credit card machine totals, and credit card settlement reports supporting student fee or other receipt transactions had no evidence, such as employee signatures, initials, or dates to show who was responsible for the accuracy or integrity of the transaction.
- **Inadequate settlement of student accounts** – The center did not take sufficient action to ensure it collected overdue student fees. As of February 2012, the center had not initiated collection of approximately \$34,000 of outstanding student fees for school year 2010-2011 and \$350 of outstanding acceptance fees for new students for the 2011-2012 school year. The center also did not refer these outstanding accounts to the Minnesota Department of Revenue's Collection Division, as required by state policy.⁹ Further, the center limited the success of the state's collection efforts because it did not collect important identifying information from the students' parents, such as social security numbers.

⁹ Department of Management and Budget Policy 0505-01, *Writing-off Uncollectible Accounts*.

Also, as of February 2012, the center had not refunded to parents balances it held for the 2010-2011 school year dormitory deposits and some cafeteria accounts.¹⁰

- **Inaccurate accounting and inadequate authorization for some adjustments to student accounts receivable** – The center did not ensure that it accurately categorized, recorded, and reported adjustments and write-offs in the student account records. For 7 of the 16 student accounts we tested, the center inappropriately recorded as write-offs other types of account adjustments, totaling \$14,375; based on records we reviewed, the adjustments seemed to be either approved need-based fee reductions or adjustments due to students' withdrawal. State policy¹¹ distinguishes between "write-offs" and "adjustments" and requires agencies to track and report to the Department of Management and Budget the uncollectible debt for compliance with state statute.¹² As a result of these errors, the center overstated the amount of uncollectable student accounts written off in its reports to the Department of Management and Budget.
- **Delayed recording to student accounts** - The center did not always post receipts to the students' accounts in a timely fashion. In fiscal year 2011, 6 of 16 student accounts we tested had payments posted up to 19 days after the date the payment was received by the center.
- **Noncompliance with deposit requirements** - The center did not deposit receipts promptly in fiscal year 2011. The center's policy¹³ requires the daily deposit of receipts exceeding \$250. Of 25 deposits tested, 14 were not deposited on a timely basis. The center deposited and entered receipts into the state's accounting system up to eight days after receipt. In September 2010, the center combined several days of receipts before making a deposit; in October 2010, the center combined up to seven days' receipts and made weekly deposits. These two months were the center's heaviest receipt months.

Because of the weaknesses in these fundamental internal controls, we tested additional student fees receipt transactions for September 2010, October 2010, September 2011, and October 2011, totaling \$430,811. While the additional testing did not find direct evidence of fraud, it did identify similar inconsistencies

¹⁰ We identified seven students cafeteria accounts for the 2010-2011 school year with balances totaling \$535.

¹¹ Department of Management and Budget Policy 0505-01, *Writing-off Uncollectible Accounts*.

¹² *Minnesota Statutes* 2011, 16D. 09.

¹³ Perpich Center for Arts Education Administrative Policy 103.15 - *Recording and Depositing Receipts*. This is a lower threshold than *Minnesota Statutes* 2011, Chapter 16A.275, which requires daily deposit when receipts total \$1000 or more.

within the accounting records. The pervasiveness of these internal control weaknesses could allow an employee to effectively mask fraudulent activity.

Recommendations

- *The center should design, implement, and monitor the effectiveness of internal controls for its student fee receipt process to ensure that it adequately safeguards receipts and creates reliable financial records. Those internal controls should at least address the following areas:*
 - *Separation of incompatible duties and incompatible computer system access, with effective mitigating controls when separation is not possible;*
 - *Retention of all documentation to support the accuracy and authorization and integrity of student fee transactions, including identification of employee accountability for transactions they process and the center's efforts to collect on outstanding accounts receivable;*
 - *Reconciliation of supporting documentation to the student fee subsystem and the state's accounting system;*
 - *Documentation of authorization and accurate classification of all student fee adjustments and write-offs;*
 - *Timely posting of transactions into the student fee subsystem; and*
 - *Timely deposit and recording of receipts in accordance with state statute and board policy.*
- *The center should review all student fee accounts; it should refund legitimate balances held from past school years and initiate collection of any legitimate outstanding balances, including referral to the Department of Revenue in accordance with state statute.*

The Perpich Center for Arts Education did not have adequate internal controls over its capital asset inventory and purchases.

Finding 2

As of May 2012, the center did not have an inventory system to track its capital assets, such as computers and equipment. Before fiscal year 2010, the center had an inventory system, but discontinued its use because it stated it no longer had the

resources to maintain the system's technology. The center also had not completed a physical inventory during fiscal years 2010, 2011, or 2012 (through May 2012) and staff did not know when the most recent inventory had been performed. (The center's inventory coordinator left the center in August 2010.)

State policy requires that agencies develop and maintain an inventory of their capital assets. State policy also requires that an agency complete a physical inventory for capital assets at least every two years and whenever there is a change in the entity's inventory coordinator.¹⁴ Without an inventory system and periodic physical inventory to verify the accuracy of the recorded inventory, the center lacked the fundamental internal controls to safeguard its capital assets against theft and loss. The center expended approximately \$400,000 for computers and other capital assets during fiscal year's 2010 and 2011.

The center did not have adequate evidence, such as a packing slip, to show that it received goods before paying the invoice for 6 of 14 purchases. In one case, the center paid a \$36,997 invoice without evidence that it had received all the items; the packing slip used to support the payment showed that 12 of the items had not yet been received.

Recommendations

- *The center should establish and maintain inventory records for its capital assets.*
- *The center should regularly perform a complete physical inventory.*
- *The center should obtain and retain evidence of the receipt of goods before the payment of the invoice.*

Finding 3

Prior Finding Partially Resolved: The Perpich Center for Arts Education did not adequately assess its financial risks or monitor the effectiveness of its internal controls.

The center did not effectively manage the risks related to important operational and finance-related legal compliance areas. Although the center resolved 13 of 17 prior audit findings, it did not ensure that employees followed policies and procedures or sufficiently monitored the effectiveness of some fundamental internal controls.

¹⁴ Department of Administration's State of Minnesota Property Management User's Guide, Section III B, Capital Asset Inventory. The Perpich Center for Arts Education also had a capital assets policy - Administrative Policy 103.28, Capital Asset Management.

Findings 1 and 2 identified significant deficiencies in the center's internal controls for receipts and capital assets. Findings 4 through 6 identify other deficiencies in the center's internal control procedures and specific noncompliance with finance-related legal requirements that were not prevented or detected by the center's internal control structure. These deficiencies created a risk of significant errors or noncompliance not being prevented or detected by the center in the normal course of operations.

The ongoing effectiveness of any internal control structure will depend on how well the center monitors the effectiveness of the controls and makes modifications to respond to changes in policy, personnel, and regulations.

Recommendation

- *The center should clearly document and frequently review its risks, internal control activities, and monitoring functions related to its operational and compliance responsibilities.*

The Perpich Center for Arts Education did not ensure that some of its employees followed the state's payroll policies related to time reporting.

Finding 4

Employees in the Residential Services Department did not always complete and submit their own electronic timesheets as a basis for payment through the state's payroll system, as required by state policy. Instead, the supervisor often completed, approved, and submitted timesheets for these employees, based on hours recorded by the center's time clock device. The center also did not validate payroll data with employees when these transactions appeared on a state payroll error report each pay period.

State payroll policy requires employees to complete their own timesheets and requires supervisors, who have direct knowledge of employees' work, to review and authorize those timesheets. The policy asserts that this provides the best control over the integrity of employees' payroll transactions and requires state agencies to validate with employees the accuracy of payroll data when a supervisor completes the electronic timesheet.¹⁵

Recommendation

- *The center should ensure that all employees complete and submit their own timesheets.*

¹⁵ Department of Management and Budget's payroll policies, PAY0016 and PAY 0017.

Finding 5

The Perpich Center for Arts Education entered into a contract without following an applicable board policy.

The center was unable to show that center staff had obtained prior board approval before entering into a \$4,800 contract with a relative of the center's executive director. A prior board chair told us that she had discussed the contract with the employee contracting for the services and verbally approved it because there was an emergency need for the services, and review of the contract could not be delayed until the next board meeting. Subsequent board meeting minutes provided no indication that the board chair informed the board about the contract or that the potential conflict of interest had been discussed. In addition, the executive director told us she was not aware that the contract required prior board approval.

The board's Executive Limitations Policy, established in November 2007, outlined specific authority given to and expectations of the executive director in the general day-to-day operations of the center. In the asset protection section,¹⁶ the policy states that the executive director may not "make purchases from or award contracts to family members or close associates...without prior approval from the board." This prior approval allows the board to ensure that the contract complies with the state's conflict of interest policy.¹⁷

Recommendation

- *The center should ensure that it obtains prior board approval for any contracts entered into with family members or close associates of the center's executive director.*

Finding 6

Prior Finding Not Resolved: The Perpich Center for Arts Education did not adequately monitor whether the Perpich Center for Arts Education Foundation complied with key terms of its contract.¹⁸

The center did not adequately monitor the Perpich Center for Arts Education Foundation's compliance with the terms and conditions of the contract in effect for the period from January 2, 2010, through January 1, 2013. The contract required, in part, for the foundation to maintain its status with the Office of the Attorney General as a charitable organization and submit to the center copies of the annual financial reports it was statutorily required to file with that office.

Although the center's executive director told us she was aware that the foundation had not filed timely annual reports with the Office of the Attorney General, there

¹⁶ Perpich Center for Arts Education's Executive Limitations Policy #6, Asset Protection, Item 7.

¹⁷ *Minnesota Statutes* 2011, 43A.38.

¹⁸ The Perpich Center for Arts Education Foundation is also known as the Perpich Foundation.

was no indication in the center's board meeting minutes that the executive director discussed this issue or its ramifications with the board. The executive director did not provide us with any documentation (such as letters, memos, or e-mails) to show how she interacted with the foundation, its board, or the center's board to resolve this critical issue that prevented the foundation from legally soliciting money for the benefit of the center, risked substantial civil penalties, and could have had a potential negative impact on the reputation of the center.

From January 2010 through May 2012, the Perpich Center for Arts Education Foundation was not registered with the Office of the Attorney General as a charitable organization and was subject to a civil penalty of up to \$25,000 if it solicited contributions. The foundation regained its status as a charitable organization in May 2012 when it filed complete financial reports for fiscal years 2009, 2010, and 2011 with the Office of the Attorney General and paid filing fees and late fees totaling \$200.

State statutes require that charitable organizations annually file with the Office of the Attorney General a registration statement,¹⁹ financial report, and copy of all tax or information returns (including all schedules and amendments) submitted to the Internal Revenue Service.²⁰

The Perpich Center for Arts Education Foundation stated that it exists to support and improve K-12 education in and through the arts for all Minnesota students.²¹ The foundation reported annual revenues of \$27,894, \$35,900, and \$20,877 for fiscal years 2009, 2010, and 2011, respectively.

Recommendation

- *The center should monitor the activity of the Perpich Center for Arts Education Foundation to ensure that it complies with the contract terms and inform the board about any issues of noncompliance.*

¹⁹ *Minnesota Statutes* 2011, 309.52, subd. 1.

²⁰ *Minnesota Statutes* 2011, 309.53, subd. 2.

²¹ The Perpich Foundation's website is available at <http://perpich.org/default.aspx>.



OLA's Comments on the Perpich Center's Response

In the following response, the Perpich Center for Arts Education asserts that it has resolved all of the 17 findings in OLA's 2008 audit report and the 6 findings in this report. We hope that assertion is well founded, but we cannot confirm it based on our recent audit work at the center. In addition, we offer the following specific comments:

- In its response to Finding 2, the center asserts that it did have inventory records subsequent to 2010. However, the center did not start using the state's Archibus system until May 2012, and it only included an inventory of the center's building and maintenance requirements. We did audit the center's records for its computers and other technology-related assets. The records were not adequate because they did not include information important to maintaining good internal controls, such as where the asset is located or which employee it is assigned to. The center did not have inventory records for any other types of fixed assets.
- In its response to Finding 3, the center refers to its 2010 Risk Assessment Plan. We reviewed the plan during our audit and concluded its scope did not primarily relate to the financial activities included in our audit.

Finally, we note again that our audit found serious weaknesses in the center's internal controls over student fee revenues. We appreciate that the center's response acknowledges these and other weaknesses, and we hope the center has made—and will sustain—the changes needed to correct them. However, we will not be able to assess the effectiveness of whatever changes the center has made until we conduct another audit.

James R. Nobles
Legislative Auditor

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor



August 27, 2012

Mr. James Nobles
Legislative Auditor
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Dear Mr. Nobles,

Thank you for providing us an opportunity to address your audit report of the Perpich Center for Arts Education. This audit, covering fiscal years 2010 and 2011, concluded with six findings, the lowest number of audit findings since fiscal year 1992, a significant accomplishment.

We acknowledge your findings and report that all have been addressed and resolved.

This chronology of improvement began in spring 2009, when the Perpich Center for Arts Education Board of Directors recognized the need to address managerial practices, accountability and organizational structure. New leadership was recruited in 2010 and a thorough analysis of operations was conducted, taking into consideration research commissioned by the board, the 17 findings of the 2008 audit, agency mission and a review of internal controls. From 2010 through 2012, qualified managers were named to develop and implement operational and financial controls to ensure advancement of the innovative educational programs and services of the Perpich Center.

Great strides forward have been made and the agency operates under a philosophy of continuous improvement.

To date, the new leadership team has resolved the current six findings and the previous 17 audit findings identified and released by the Legislative Auditor in 2008. In addition, Perpich Center leadership has addressed areas beyond the audit findings in order to affirm sound business practices and effective internal controls.

Perpich leadership is confident that the agency's July 2012 Internal Controls Report to Minnesota Management and Budget illustrates the agency's continued focus on quality control and compliance measures that meet or exceed state standards.



We differ with some of the conclusions in the current audit about applicable board policies and our relationship with the Perpich Foundation. Our board practices good management oversight and monitors internal controls, but understands the need to remain flexible to respond in the state's best interest to urgent needs when they arise.

Had the current board of directors been consulted during the auditors' fieldwork, it could have added beneficial clarification to board governance and the decision-making processes.

We share common goals with your office concerning good stewardship and efficient use of taxpayer dollars and thank you for the excellent suggestions for improvement we received from your staff.

We take our mission to improve education seriously.

Respectfully yours,

Susan Mackert
Executive Director

Todd Liljenquist
Board Chair

Bari Amadio
Past Board Chair

Pierce McNally
Board Finance Chair



Auditor Finding 1

Prior Finding Not Resolved: The Perpich Center for Arts Education had fundamental internal control weaknesses in its processes to collect, deposit, and accurately record receipts of student fees.¹

Perpich Response

Resolved prior to audit report. In the process of our own internal review, Perpich Center had already identified and developed processes to ensure solid internal controls, including all recommendations made by the auditor. All recommendations have been implemented.

Auditor Finding 2

The Perpich Center for Arts Education did not have adequate internal controls over its capital asset inventory and purchases.

Perpich Response

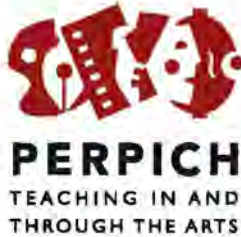
Resolved. The Perpich Center does have inventory records and regularly keeps track of newly acquired inventory. Since 7/1/11 when the state's new accounting system (SWIFT) became available, all purchases were and continue to be entered into SWIFT. After the previous audit was released in 2008, the Perpich Center removed a former system (4D) for security purposes. Building inventory was maintained in Archibus (the Department of Administration's facilities management system) and technology inventory records were kept on spreadsheets in the Perpich Center technology office.

In the summer of 2012, when the SWIFT inventory module became functional, the center provided all previous inventory lists to Minnesota Management and Budget for uploading.

The Perpich Risk Management Team determined that the financial threshold for recording inventory should be significantly lower than state recommendations in order to better safeguard agency assets, taking into consideration that the Perpich Center operates a residential secondary school within a state agency. In the latest complete physical inventory, Perpich Center verified 873 items exceeding a total dollar value of \$622,563.00.

Accounts payable receives packing slips for most items purchased; however, some vendors do not include packing slips with merchandise. When packing slips are not available, staff members obtain approval from appropriate personnel to verify that the goods or services were received. In the instance cited, the Administrative Management Director received confirmation from technology staff that all of the shipment had arrived prior to the invoice being paid.

¹ This finding relates to student fees collected from parents/guardians – not funds allocated by the Legislature through the state's general fund.



Auditor Finding 3

Prior Finding Partially Resolved: The Perpich Center for Arts Education did not adequately assess its financial risks or monitor the effectiveness of its internal controls.

Perpich Response

Resolved. This chronology of improvement began in spring 2009, when the Perpich Center for Arts Education Board of Directors recognized the need to address managerial practices, accountability and organizational structure. New leadership was recruited in 2010 and a thorough analysis of operations was conducted, taking into consideration research commissioned by the board, the 17 findings of the 2008 audit, agency mission and a review of internal controls. From 2010 through 2012, qualified managers were named to develop and implement operational and financial controls to ensure advancement of the innovative educational programs and services of the Perpich Center. Great strides forward have been made and the agency operates under a philosophy of continuous improvement.

To date, the new leadership team has resolved the current six findings and the previous 17 audit findings identified and released by the Legislative Auditor in 2008. In addition, Perpich Center leadership has addressed areas beyond the audit findings in order to affirm sound business practices and effective internal controls. Process improvements have been made in the following areas:

- Payroll and Human Resource Practices
- Accounts Payable and Accounts Receivable
- Purchasing
- Contracts
- Planning and Risk Assessment
- Records Retention
- Board Governance

In 2010, a Crisis Team was identified and a Risk Assessment Plan was adopted and continues to be updated. This overarching plan has allowed Perpich Center to operate a safe and effective learning environment, to have crisis measures in place, and particularly to address the needs of operating a residential secondary school as a state agency, delivering a quality educational program onsite and throughout the state.

Perpich leadership is confident that the agency's July 2012 Internal Controls Report to Minnesota Management and Budget illustrates the agency's continued focus on quality control and compliance measures that meet or exceed state standards.

The new state finance management system (SWIFT), implemented by Minnesota Management and Budget, enables small agencies like ours to have access to a secure, fully integrated business system, which previously was not available.

**Auditor Finding 4**

The Perpich Center for Arts Education did not ensure that some of its employees followed the state's payroll policies related to time reporting.

Perpich Response

The center will continue to provide training to residence hall employees so that residence hall employees learn how to accurately use the state's online time-keeping system. The supervisor will hold residence hall employees accountable for employee time entry and implement disciplinary action, if needed. Our supervisors appropriately corrected inaccurate time entry by residence hall employees and this supervisory responsibility will continue in order to prevent inaccurate recording of work time by residence hall employees and, therefore, avoiding potential errors in payments to residence hall employees. Supervisor will validate corrected entries with employee.

Auditor Finding 5

The Perpich Center for Arts Education entered into a contract without following an applicable board policy.

Perpich Response

The Board chair approved the 90-day contract to fill an urgent need occasioned by the person duly hired disappearing. Contract procedures delegated by the Department of Administration were followed in the hiring of this contractor. The Perpich Board chair felt confident that the approval was within operating guidelines requiring protection of state assets, parameters and discretionary governance provided board chairs and that the decision did absolutely comply with the state's conflict of interest policy (MS§43A.38).

Auditor Finding 6

Prior finding not resolved: The Perpich Center for Arts Education did not adequately monitor whether the Perpich Center for Arts Education Foundation complied with key terms of its contract.

Perpich Response

The Perpich Foundation is a separate legal entity recognized by the Internal Revenue Service (IRS) as a 501(c)3 nonprofit organization with its own governing board. Foundation leadership effectively addressed their compliance status in cooperation with and under guidance from the Office of the Attorney General and the IRS. Their registration has been continued and we are confident that measures have been put in place to avoid future problems. The Perpich Center and its Board of Directors play no legal role in governance of the Foundation. We do informally monitor the activity, promote full compliance and understand the administrative challenges of a volunteer-driven organization. The Foundation Board President addresses the Perpich board on an annual basis.