



FINANCIAL AUDIT DIVISION REPORT

Minnesota State Arts Board

Internal Controls and Compliance Audit

May 1, 2010, through April 30, 2012

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

September 20, 2012

Report 12-19

FINANCIAL AUDIT DIVISION

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OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

September 20, 2012

Representative Michael Beard, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Ms. Ellen McInnis, Chair
Minnesota State Arts Board

Members of the Minnesota State Arts Board

Ms. Sue 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 May 1, 2010, through April 30, 2012. 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 September 11, 2012. This audit was conducted by Brad White, CPA, CISA, CFE (Audit Manager) and Lindsay Tietze, CPA (Auditor-in-Charge), assisted by auditor Emily Wiant.

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

A handwritten signature in black ink that reads "James R. Nobles".

James R. Nobles
Legislative Auditor

A handwritten signature in black ink that reads "Cecile M. Ferkul".

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

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Report Summary

Conclusion

The Minnesota State Arts Board's internal controls were generally adequate to ensure that it safeguarded its financial resources, accurately paid grantees in accordance with management's authorizations, created reliable financial data, and complied with significant finance-related legal requirements, including provisions relevant to the Arts and Cultural Heritage Fund.

For the items tested, the board generally complied with significant requirements contained in statutes, laws, grant agreements, and entity policies. However, the Minnesota State Arts Board had weaknesses and instances of noncompliance in the area of grant monitoring. The board partially resolved one prior audit finding related to risk assessment and monitoring and resolved a second finding related to administrative cost limits for the regional arts councils.

Finding

- The Minnesota State Arts Board did not effectively monitor grantees to ensure they used money granted from the state's general, federal, and Arts and Cultural Heritage funds in accordance with the specific appropriations and grant agreements. ([Finding 1, page 9](#))

Audit Objectives and Scope

Objectives

- Internal Controls
- Legal Compliance

Period Audited

May 1, 2010, through April 30, 2012

Programs Audited

- Administration and oversight of grants (including grants from the Arts and Cultural Heritage Fund)
-

Minnesota State Arts Board

Overview

The Minnesota State Arts Board is a state agency whose mission is to stimulate and encourage the creation, performance, and appreciation of the arts in the state. It was established in 1975 and operates under the authority of *Minnesota Statutes* 2011, 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. Table 1 shows the board's sources of funding for fiscal years 2010 through 2012.

Table 1
Minnesota State Arts Board
Sources of Funding
Fiscal Years 2010 through 2012

Source of Funding	2010	2011	2012
General Fund Appropriations	\$ 8,624,000	\$ 8,624,000	\$ 7,506,000
Arts and Cultural Heritage Fund Appropriations	21,650,000	21,650,000	22,167,000
Federal Grant - National Endowment for the Arts	947,806	823,709	839,955
Miscellaneous (Gifts and Other Receipts)	6,254	40,447	115,975
Total	<u>\$31,227,910</u>	<u>\$31,138,156</u>	<u>\$30,628,930</u>

Note: Unspent appropriations are allowed to carry forward into subsequent fiscal years within the biennium.

Source: State of Minnesota accounting systems.

The appropriations from the Arts and Cultural Heritage Fund, one of the sales tax supported Legacy funds,¹ began in fiscal year 2010. This additional funding allowed the board to significantly expand the number and size of grants to arts organizations and individual artists across Minnesota.

The board used these resources to administer and award grants for arts and arts access initiatives, arts education, and arts and cultural heritage events and activities through the following programs and organizations:

Institutional/Operational Support Program – This was the board's largest grant program; it was funded by appropriations from both the General Fund

¹ 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.

and Arts and Cultural Heritage Fund. The program provided unrestricted operating support to tax-exempt nonprofit arts organizations that produced or exhibited works of art or offered a broad range of services to artists.

Regional Arts Councils – In 1977, the regional arts council system was created to provide an effective means to distribute arts funds throughout the state. The board distributed money appropriated from the General Fund and the Arts and Cultural Heritage Fund to 11 regional arts councils in Minnesota. The Regional Arts Council Forum allocated legislative appropriations designated for the councils using a formula based on land area and populations reported in the most recent census.²

Other Grants – The board provided grants to individual artists and organizations through several other programs, including Artist Assistance, Arts Tours, Arts in Education, and other programs where presenters produced live public performances, exhibitions, or screenings in the visual, performing, and literary arts. A large number of individual artists and presenters received grants limited to a maximum up to \$10,000 each.

Table 2 summarizes the board's expenditures for fiscal years 2011 and 2012.

Table 2
Expenditures by Type
July 1, 2010, through June 30, 2012

Expenditures by Type:	Fiscal Year	
	2011	2012
Grants	\$32,140,964	\$30,315,678
Payroll and Per Diems	831,365	947,572
Other Administrative and Operating Expenditures ¹	756,612	412,309
Total Expenditures	<u>\$33,728,941</u>	<u>\$31,675,559</u>

¹ Other administrative and operating expenditures included rent, professional contract services, computer services, supplies and equipment, travel, and other operating costs.

Source: State of Minnesota accounting systems.

Table 3 categorizes the Minnesota State Arts Board's fiscal year 2011 grants by recipient type and funding source.

² *Minnesota Rules* 1900.2410, subp. 14, identifies the Regional Arts Council Forum as a not-for-profit 501(c)(3) voluntary membership association of the 11 regional arts councils formed to provide resources, deal with common issues, and develop mutual support among regional arts councils in Minnesota.

Table 3
Grant Expenditures by Recipient Type and Funding Source
July 1, 2010, through June 30, 2011

<u>Recipient Type</u>	<u>Arts & Cultural Heritage Fund</u>	<u>General Fund</u>	<u>Federal Fund</u>	<u>Gift Fund</u>
Arts Organizations	\$14,551,342	\$4,800,623	\$376,698	\$31,682
Regional Arts Councils	6,330,000	2,303,000	0	0
Individual Artists	913,500	250,000	558,741	0
Colleges and Universities	748,926	232,345	0	1,746
Schools	578,006	0	10,310	0
Cities and Towns	403,950	37,630	12,465	0
Total Expenditures	<u>\$23,525,724</u>	<u>\$7,623,598</u>	<u>\$958,214</u>	<u>\$33,428</u>

Source: Minnesota Accounting and Procurement System.

Objective, Scope, and Methodology

The objective of our audit of the Minnesota State Arts Board's administration and oversight of grants for the period of May 1, 2010, through April 30, 2012, was to answer the following questions:

- Were the board's internal controls adequate to ensure that it safeguarded its financial resources, accurately paid grantees in accordance with management's authorizations, created reliable financial data, and complied with significant finance-related legal provisions, including provisions relevant to the Arts and Cultural Heritage Fund?
- Did the board comply with significant finance-related legal requirements contained in statutes, laws, grant agreements, and entity policies, including provisions relevant to the Arts and Cultural Heritage Fund?
- Did the board resolve prior audit findings?³

To meet the audit objective, we gained an understanding of the Minnesota State Arts Board's financial policies and procedures. We considered the risk of errors in the accounting records and potential noncompliance with relevant legal requirements. We analyzed accounting data to assess compliance with statutory administrative cost limitations and 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

³ Office of the Legislative Auditor's Financial Audit Division Report 10-26, *Minnesota State Arts Board*, issued August 12, 2010.

effective and if the transactions complied with laws, regulations, policies, and grant and contract provisions.

We performed audit work at four arts organizations receiving large grants through the board. Table 4 identifies the organizations examined and total amount of grants the board awarded to them in fiscal years 2010 through 2012.

Table 4
Selected Grantees
July 1, 2009, through June 30, 2012

Grantee	Amount Awarded		
	2010	2011	2012
Metropolitan Regional Arts Council	\$3,579,503	\$3,432,974	\$3,374,416
Minnesota Orchestral Association	\$1,009,881	\$1,150,359	\$1,069,284
Guthrie Theatre Foundation	\$ 858,999	\$1,032,779	\$ 840,089
Walker Art Center	\$ 735,455	\$ 735,455	\$ 658,948

Source: Minnesota State Arts Board grants management system.

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 control and compliance. We used, as our criteria to evaluate agency controls, the guidance contained in the *Internal Control-Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission.⁴ We used state and federal laws, regulations, and contracts, as well as policies and procedures established by the departments of Management and Budget and Administration and the Minnesota State Arts Board's internal policies and procedures as evaluation criteria over compliance.

Conclusion

The Minnesota State Arts Board's internal controls were generally adequate to ensure that it safeguarded its financial resources, accurately paid grantees in accordance with management's authorization, created reliable financial data, and complied with significant finance-related legal requirements, including provisions relevant to the Arts and Cultural Heritage Fund.

⁴ 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.

For the items tested, the board generally complied with significant requirements contained in statutes, laws, grant agreements, and entity policies, including provisions relevant to the Arts and Cultural Heritage Fund. However, the board had some control weaknesses and instances of noncompliance related to its grant monitoring processes. The board partially resolved one prior audit finding related to risk assessment and monitoring and resolved a second finding related to administrative cost limits for the regional arts councils.

The following *Finding and Recommendation* further explain the board's internal controls and compliance weaknesses.

Finding and Recommendation

The Minnesota State Arts Board did not effectively monitor grantees to ensure they used money granted from the state’s general, federal, and Arts and Cultural Heritage funds in accordance with the specific appropriations and grant agreements.

Finding 1

The board did not comply with certain state policies designed to ensure grantees used grant money for purposes allowed by the specific appropriations and grant agreements. The board had the following noncompliance with state grant policies:

- Prior Finding Partially Resolved⁵ - Grantee Reconciliations and Monitoring: In response to a prior audit finding, the board completed an assessment of the risks in its grant processes and the internal controls designed to mitigate those risks; however, it did not monitor those controls to ensure it complied with state grant policies. For example, the board had not complied with state policy⁶ to conduct financial reconciliations of grantee expenditures at least once during the grant period on grants over \$50,000. A financial reconciliation involves requesting supporting documentation, such as purchase orders, receipts, or payroll records, to support costs. In addition, board staff did not perform any monitoring visits for 20 grants over \$50,000 that we examined; however, staff asserted they may have performed administrative site visits at some of the grantees, but neglected to document those visits. State policy⁷ requires at least one monitoring visit per grant period on grants over \$50,000. State policy⁸ also requires all advance payments on grants to be reconciled within 12 months of issuance or within 60 days of the end of the grant period, whichever comes first. Finally, the board did not develop procedures to comply with state policy⁹ to consider a grant applicant’s past performance before awarding subsequent grants.
- Final Reports - Individual Artists and Arts Organizations: The board did not have sufficient internal controls related to the collection and timely review of final reports, along with follow up on significant spending

⁵ Office of the Legislative Auditor’s Financial Audit Division Report 10-26, [Minnesota State Arts Board](#), issued August 12, 2010, Finding 1.

⁶ Minnesota Department of Administration, Office of Grants Management Policy 08-10. In fiscal year 2011, the board requested and received an exemption from this policy for their operating support grant program. However, the board did not receive an exemption for all the other grant programs it administered.

⁷ Minnesota Department of Administration, Office of Grants Management Policy 08-10. A monitoring visit involves communication between the board and grantee to review the progress of goals and address any issues or concerns.

⁸ Minnesota Department of Administration, Office of Grants Management Policy 08-08.

⁹ Minnesota Department of Administration, Office of Grants Management Policy 08-13.

variances, submitted by grantees. As of February 29, 2012, for grants executed during fiscal years 2010 and 2011, the board had not received 443 (out of 1,472) final grant reports within 30 days after the end of the grant period; 62 of those final reports were more than 90 days past due. In addition, board staff did not review final reports filed by nine grantees in a timely manner; the board completed the reviews between four and eight months after receiving those reports. Finally, the board did not obtain explanations or justifications from the grantees whose final reports we reviewed showed significant variances between approved spending budgets and actual grant costs they reported.¹⁰

Grant agreements required submission of a final report 30 days after the grant period end date to inform the board of actual outcomes, impact, and costs of the grant projects. The board had developed procedures to remind grantees with overdue reports about the reporting requirement; however, the board suspended those procedures in June 2011 due to the imminent state shutdown¹¹ and did not immediately perform the procedures after the shutdown ended.

- Financial Reports - Regional Arts Councils: The board's process to review reports submitted by the regional arts councils was not effective to show the board's due diligence to ensure the grantee's accountability for the use of grant funds and its compliance with grant agreements and *Minnesota Rules*. The board's informal and undocumented reviews of these reports may lead to inconsistencies in the scope and focus of reviews performed, criteria used to assess a report's completeness or deficiencies, and the steps required to resolve identified concerns and documentation. A formal review process may have identified the following concerns:
 - One regional arts council's report did not separately account for state grant monies, including Arts and Cultural Heritage Funds. As a result, it was unable to directly show how it had used specific grant money in compliance with legal requirements or how much of its \$626,845 investment balance at June 30, 2011, was generated from unspent or unobligated state grant funds. For example, without separate accounting for specific costs, the council cannot identify which costs it paid with grants from the Arts and Cultural Heritage Fund, and the board cannot assess whether those costs complied with the statutory requirement that the costs be "directly related to and necessary for" the

¹⁰ The board defines a significant difference as an actual cost variance of 20 percent or greater for a grant budget category.

¹¹ From July 1 through July 20, 2011, much of the State of Minnesota's government operations shut down, including the operations of the Minnesota State Arts Board. The shutdown occurred because the 2011 Legislative Session ended without reaching an agreement on budget appropriations to fund operations of state government. Without appropriations, most state agencies had no authority to continue operations beyond June 30, 2011.

purposes of the grant.¹² In addition, if the investment balance included unspent state funds (which is likely because much of the regional arts council's funding is through state grants) *Minnesota Rules* required the council to request authorization from the board to carry funds over to the next fiscal year or biennium (to the extent of its obligations related to the grant), and it did not return to the board any unobligated amounts.¹³

- Another regional arts council included in its request to carry grant funds over into the next biennium \$55,454 of grant money that it had not obligated. *Minnesota Rules* require a grantee to return any unobligated funds to the board.¹⁴

While the Minnesota State Arts Board had an adequate process to select grantees and award grants, weaknesses in grant oversight could undermine its ability to ensure that grantees use money provided through their grants in accordance with legislative appropriations, *Minnesota Rules*, board policies, and grant agreements.

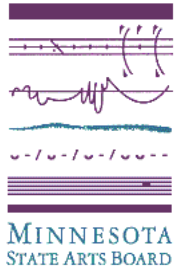
Recommendation

- *The Minnesota State Arts Board should improve internal controls over grants by:*
 - *completing financial reconciliations and monitoring grantees to ensure compliance with state policies;*
 - *ensuring they receive final reports from all grantees and performing a timely review of those reports;*
 - *requiring that regional arts councils separately track their use of state grant funds; and*
 - *documenting the review of reports from regional arts councils, addressing any concerns with carryover of funds into the next fiscal year or biennium, and ensuring that unobligated funds are returned to the board.*

¹² *Laws of Minnesota* 2011, 1st special session, ch. 6, art. 4, sec. 2, subd. 2, required that funds “may not be spent on activities unless they are directly related to and necessary for a specific appropriation.”

¹³ *Minnesota Rules*, Part 1900.3710, 1900.3810, and 1900.3910.

¹⁴ *Minnesota Rules*, Part 1900.3910.



September 17, 2012

James Nobles, Legislative Auditor
Office of the Legislative Auditor
Room 140 Centennial Building
658 Cedar Street
Saint Paul, Minnesota 55155-1603

Dear James Nobles,

The Minnesota State Arts Board appreciates the careful and thorough review the Office of the Legislative Auditor has made of our agency's internal controls, financial management, and compliance. Our agency places a high priority on stewardship of State funds and welcomes suggestions on ways that we can strengthen our procedures.

The following is our response to the one finding and recommendation contained in your audit report.

➤ **Prior finding partially resolved — Grantee reconciliations and monitoring**

OLA recommendation — Complete financial reconciliations and monitor grantees to ensure compliance with state policies

Agency response — The Arts Board agrees with this finding and recommendation.

The board has been working diligently to strengthen its internal control environment and ensure that it complies with all state policies. It has put in place a number of new processes in the area of grant oversight. It has created and implemented a process for monitoring project grants, and will improve its process for documenting monitoring visits with operating support grantees. It has developed a process to take past performance into account when awarding new grants; that process will be put in place in the coming year. The board will work with the State's Office of Grants Management to ensure that additional measures that will be put in place for monitoring grantees and financial reconciliation of grants are consistent with existing state policies.

Person responsible: David White, director of finance and grants administration
Complete by: June 30, 2013

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➤ **Final reports — Individual artists and arts organizations**

OLA recommendation — Ensure that final reports are received from all grantees and perform a timely review of those reports

Agency response — The Arts Board agrees with this finding and recommendation.

Due to technology limitations, much of the Arts Board's process for alerting grantees that reports are coming due; receiving, reviewing, and approving reports; and providing feedback to grantees is carried out manually. The board processes approximately 500-600 grants per year. The board will convert to a new online life-cycle grants management system during fiscal year 2013 that will automate many of these processes. The goal is to achieve greater efficiency in the "mechanics" of the process so that more staff time can be devoted to timely review and evaluation of final reports.

Person responsible: David White, director of finance and grants administration

Complete by: June 30, 2013

➤ **Financial reports — Regional arts councils**

OLA recommendation — Require that regional arts councils separately track their use of state grant funds; and

Document the review of reports from regional arts councils, addressing any concerns with carry over of funds into the next fiscal year or biennium, and ensuring that unobligated funds are returned to the board.

Agency response — The Arts Board agrees with this finding and recommendation.

The board has ongoing conversations with regional arts councils about ways to strengthen accountability for state funds and clarify reporting on the use of those funds. A financial template has been collaboratively developed by which regional arts councils report their use of funds by source, but the board also will reinforce the message that regional arts council's internal accounting systems must be able to track state funds separately from other sources of support.

Regional arts councils reports and financial documents are reviewed by agency staff; going forward the board will put in place a more formal way to document the results of those reviews and analyses. Regional arts councils currently provide notice when they intend to carry funds forward from one fiscal year to the next or from one biennium to the next. A more structured process will be put in place by which regional arts councils will request approval to carry funds forward and document how those funds would be used; the board will ensure that unobligated funds are returned.

Person responsible: Sue Gens, executive director

Complete by: June 30, 2013

James Nobles, Office of the Legislative Auditor
Minnesota State Arts Board
September 17, 2012 | page 3

We appreciate the opportunity to address the finding and recommendation of the Office of the Legislative Auditor and will be happy to answer any questions that may be prompted by this response.

Sincerely,

A handwritten signature in black ink that reads "Sue Gens" followed by a horizontal flourish line.

Sue Gens
Executive director