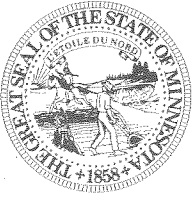


**DEPARTMENT OF ENERGY AND
ECONOMIC DEVELOPMENT
FINANCIAL AND COMPLIANCE AUDIT
FOR FISCAL YEARS 1984 AND 1985**

APRIL 1986



STATE OF MINNESOTA

OFFICE OF THE LEGISLATIVE AUDITOR

VETERANS SERVICE BUILDING, ST. PAUL, MN 55155 • 612/296-4708

JAMES R. NOBLES, LEGISLATIVE AUDITOR

Senator Randolph W. Peterson, Chairman
Legislative Audit Commission

Members of the Legislative Audit Commission

and

Mr. Mark B. Dayton, Commissioner
Department of Energy and Economic Development

Audit Scope

We have completed a financial and compliance audit of the Department of Energy and Economic Development for fiscal years 1984 and 1985. Section I provides a brief description of the Department of Energy and Economic Development's activities and finances. Our audit was made in accordance with generally accepted auditing standards, and the standards for financial and compliance audits contained in the U.S. General Accounting Office Standards for Audit of Governmental Organizations, Programs, Activities, and Functions, and accordingly, included such audit procedures as we considered necessary in the circumstances. Field work was completed on February 14, 1986.

The financial activities of the Energy and Economic Development Fund were audited by a certified public accounting firm for fiscal years 1984 and 1985. We have reviewed and relied upon the work of the certified public accounting firm in establishing our scope and objectives.

We have issued separate management letters, dated February 14, 1985 and February 14, 1986, as a part of our Statewide and Single Audit work in the department for fiscal years 1984 and 1985. The management letters contained five recommendations for fiscal year 1984 and four recommendations for fiscal year 1985, relating primarily to the administration of federal programs by the department.

The objectives of the audit were to:

- study and evaluate major Department of Energy and Economic Development (DEED) internal control systems, including a review of receipts, payroll, fixed assets, and administrative and grant disbursements;
- verify that financial transactions were properly recorded in Statewide Accounting System; and
- verify that financial transactions were made in accordance with applicable laws, regulations, and policies.

The management of DEED is responsible for establishing and maintaining a system of internal accounting control. In fulfilling this responsibility, estimates and judgements by management are required to assess the expected benefits and related costs of control procedures.

The objectives of a system are to provide management with reasonable, but not absolute assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly.

Because of inherent limitations in any system of internal accounting control, errors or irregularities may occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions, or that the degree of compliance with the procedures may deteriorate.

The management of DEED is also responsible for the agency's compliance with laws and regulations. In connection with our audit, we selected and tested transactions and records from the programs administered by DEED. The purpose of our testing of transactions was to obtain reasonable assurance that DEED had, in all material respects, administered its programs in compliance with applicable laws and regulations.

Audit Qualification

During the audit period, the department inappropriately coded various expenditures made for promotional purposes as advertising, irrespective of the type of expenditure. This practice was consistent with a former statutory requirement which was repealed in 1983. Departmental staff were not aware of the statutory change. They revised their procedures, to comply with Department of Finance guidelines, during fiscal year 1986.

Conclusions

In our opinion, except for the issues raised in Section II of this report and in our management letter dated February 14, 1986, the DEED system of internal accounting control in effect on January 31, 1986, taken as a whole, was sufficient to provide management with reasonable, but not absolute assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization.

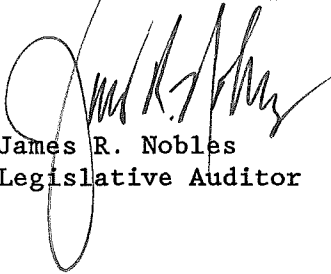
In our opinion, except for the issue raised in the audit qualification paragraph, for the years ended June 30, 1984 and 1985, the financial transactions of DEED were properly recorded in the Statewide Accounting System.

In our opinion, for the years ended June 30, 1984 and 1985, DEED administered its programs in compliance, in all material respects, with applicable finance-related laws and regulations.

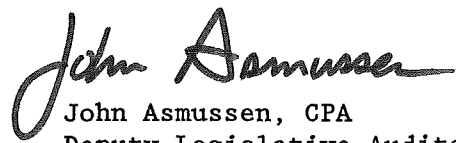
Senator Randolph W. Peterson
Members of the Legislative Audit Commission
and
Mr. Mark B. Dayton
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Section II of this Audit Report contains the recommendations we developed during this audit. It is presented to assist you in improving accounting procedures and controls. We will be monitoring and reviewing your progress on implementing these recommendations.

We would like to thank the Department of Energy and Economic Development staff for the cooperation extended to us during this audit.



James R. Nobles
Legislative Auditor



John Asmussen, CPA
Deputy Legislative Auditor

April 23, 1986

DEPARTMENT OF ENERGY AND ECONOMIC DEVELOPMENT

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AUDIT PARTICIPATION

The following members of the Office of the Legislative Auditor participated in this audit:

| | |
|------------------------|----------------------------|
| John Asmussen, CPA | Deputy Legislative Auditor |
| Claudia Gudvangen, CPA | Audit Manager |
| Monica Lawyer | Auditor-in-Charge |
| Beth Widstrom-Anderson | Staff Auditor |
| Sandra Linn | Staff Auditor |
| Patrick Ryan | Staff Auditor |

EXIT CONFERENCE

Exit conferences were held with the following DEED staff on April 4 and 8, 1986:

| | |
|----------------|---|
| Mark Dayton | Commissioner |
| Liz Anderson | Senior Administrative Officer |
| Jim Gelbmann | Executive Assistant to the Commissioner |
| Terry Pohlkamp | Administrative Management Director |

DEPARTMENT OF ENERGY AND ECONOMIC DEVELOPMENT

SECTION I. INTRODUCTION

The Department of Energy and Economic Development (DEED) was established in July 1983 replacing the former Department of Energy, Planning and Development. The State Planning Agency was also reestablished as a separate agency to administer the planning functions of the former department.

Major activities of DEED include:

- development and implementation of energy conservation programs;
- providing management and marketing assistance to small businesses;
- administration of various community and economic development grants to local units of government;
- providing economic development loans to small businesses; and
- working with local organizations and business and conducting advertising and other marketing activities to increase travel expenditures in the state.

Activities of DEED are financed primarily through General Fund appropriations and federal grants. Fiscal year 1985 departmental expenditures, including encumbrances, on a budgetary basis, were as follows:

| | <u>GENERAL FUND</u> | <u>FEDERAL FUND</u> | <u>OTHER FUNDS</u> | <u>TOTAL</u> |
|-----------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
| Personal Services | \$ 6,263,485 | \$ 1,337,344 | \$ 197,150 | \$ 7,797,979 |
| Expense & Contractual | | | | |
| Services | 6,030,505 | 621,327 | 920,651 | 7,572,483 |
| Supplies & Materials | 276,960 | 18,483 | 4,963 | 300,406 |
| Equipment | 309,983 | 23,800 | 2,347 | 336,130 |
| Debt Redemption | | | 30,856 | 30,856 |
| Grants & Aid | 19,831,688 | 23,398,483 | 473,443 | 43,703,614 |
| Redistributed Costs | | 67,652 | 49,649 | 117,301 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| TOTAL | <u>\$32,712,621</u> | <u>\$25,467,089</u> | <u>\$1,679,059</u> | <u>\$59,858,769</u> |

In addition, approximately \$9 million in loans were issued for the various programs in the Energy and Economic Development Fund.

The Commissioner is the administrative head of the department. Mark Dayton has served as Commissioner of DEED since its establishment on July 1, 1983.

DEPARTMENT OF ENERGY AND ECONOMIC DEVELOPMENT

SECTION II. CURRENT FINDINGS AND RECOMMENDATIONS

Policies and procedures to control promotional expenditures should be developed.

The Department of Energy and Economic Development (DEED) provides grants and loans to various public and private entities and also expends funds to administer the various programs for which it is responsible. As a state agency, DEED is required to follow various centralized procedures and controls over the expenditure of state funds. However, DEED has expanded authority and certain flexibility not available to other state agencies.

Minn. Stat. Section 116J.60 provides:

"In the promotion of tourism and economic development of the state, the commissioner of energy and economic development may expend money appropriated by the legislature for these purposes in the same manner as private persons, firms, corporations, and associations make expenditures for these purposes. An expenditure for food, lodging, or travel is not governed by the travel rules of the commissioner of employee relations. No money shall be expended for the appearance in radio or television broadcasts by an elected public official."

In addition, Minn. Stat Section 116J.58, Subd. 2 provides:

"In order to best carry out his duties and responsibilities and to serve the people of the state in the promotion of tourism and economic development the commissioner may engage in programs and projects jointly with a private person, firm, corporation or association and may enter into contracts under terms to be mutually agreed upon to carry out such programs and projects not including acquisition of land or buildings. Such contracts may be negotiated and shall not be subject to the provisions of chapter 16, insofar as such provisions relate to competitive bidding."

DEED expends its promotional funds on various items and events including luncheons, dinners, and seminars to promote Minnesota, travel expenses for participants in these events, various publications, promotional items and souvenirs and other special events. DEED has not developed formal internal policies and procedures to control the expenditure of promotional funds. It is important that appropriate guidelines and controls be developed when an agency is not subject to established centralized procedures such as those provided by the Departments of Administration, Employee Relations and Finance. An agency may be forced to start from scratch in developing a system if it is going to depart from established guidelines. One alternative would be to generally follow the centralized procedures and controls and to identify those instances when other policies would apply.

DEPARTMENT OF ENERGY AND ECONOMIC DEVELOPMENT

Internal policies and procedures are necessary to define the type of expenditures which qualify as promotional and to provide assurances that these expenditures are appropriate and authorized by management. The policies should contain various guidelines including:

- The types of activities and expenditures which are considered promotional and thus not subject to regular state procedures. The policy should also address which sections of the department engage in promotional activities and who has authority to approve expenditures in this area.
- The types of controls over purchasing which will be followed when the state's procedures are not required.
- The basis to be used for reimbursement of travel and other expenses if the Department of Employee Relations guidelines are not followed.

Although DEED is not required to comply with centralized controls for promotional expenditures, in the past they have generally followed established procurement and expense reimbursement guidelines. As a result, we have not identified broad-based problems with expenditure controls. However, we believe that where flexibility and expanded authority exist, formalized policies and guidelines should be established so that all staff are aware of proper procedures and future expenditures are adequately controlled.

We identified one specific expenditure area where controls should be strengthened. DEED periodically charters private aircraft to transport the commissioner and other staff to various meetings throughout the state. The invoices for these services did not identify the purpose of the trips, and in some instances did not identify the passengers on the flights. We were subsequently able to satisfy ourselves as to the propriety of these expenditures; however, we believe that in the future better documentation should be maintained on an on-going basis. In order to properly monitor these expenditures and determine their propriety, all persons using the charter service and the purpose of the trip should be identified on the invoice or other supporting documentation.

In addition, the department was not effectively monitoring the availability of discounts for prompt payment of various invoices. For example, during fiscal year 1985 and the first five months of fiscal year 1986, DEED paid one vendor a total of approximately \$35,000 for chartered aircraft services. The invoices provided that a discount of 10 percent of the base charter fee could be taken if payment was received within a specified period of time. Our review identified approximately \$1,500 in available discounts which were not taken on these payments.

RECOMMENDATIONS:

1. DEED should develop internal policies and procedures which provide guidelines for the expenditure of funds for promotional purposes.

DEPARTMENT OF ENERGY AND ECONOMIC DEVELOPMENT

2. *The department should improve documentation over charter airline expenditures by identifying the purpose of and passengers on the various flights.*
3. *DEED should institute procedures to ensure that all available discounts are taken.*

DEED has not appropriately controlled their fixed asset inventory.

The Department of Administration establishes guidelines for control of fixed assets by state agencies. Generally, Administration requires that a system for periodically spot-checking inventory be developed. Normally each area of the agency should be checked on a semi-annual or annual basis depending on past accuracy. A complete physical inventory should be taken whenever it is determined that record accuracy has deteriorated below an acceptable level.

DEED has not established a policy for control of fixed assets as recommended by the Department of Administration Inventory Management Division in their Fixed Asset Inventory User's Manual. DEED has not performed a complete fixed asset inventory or periodic spot-checks since it was reorganized in July 1983. At the time of the reorganization, the assets of the former Department of Energy, Planning and Development were transferred to DEED and the State Planning Agency. Adequate records were not maintained to document the specific assets obtained by each department, and a physical inventory was not taken at the time of the transfer. Similar problems regarding the validity of inventory records were found in our last audit of the State Planning Agency. A physical inventory should be completed to ensure that all assets can be located and are properly marked, to verify that fixed asset records are accurate, and to verify that all assets and related records were properly transferred during any reorganization.

The User's Manual specifies procedures which must be followed when state employees' use personal property in connection with their employment. These procedures must be followed to differentiate personal property from state owned property. The User's Manual also indicates that all donated items received by the state must be included on the fixed asset inventory whenever the value meets or exceeds certain criteria.

In our testing of the fixed asset area we noted the following:

- We were unable to locate 19 of 24 items listed on DEED's fixed asset listing. One item, a photocopy machine, had not been removed from the listing when sold. A computer terminal, with an original cost of \$10,000, also could not be located. The inability to locate so many items was due in part to the fact that the inventory records did not accurately represent the assets obtained by DEED at the time of reorganization of the prior department. In addition, the inventory records did not indicate the correct location of the assets.

DEPARTMENT OF ENERGY AND ECONOMIC DEVELOPMENT

- Various assets sighted in the department were not marked with the appropriate asset number. This included approximately 100 framed photographs and various chairs, tables, and computers.
- Other assets found in the department were not recorded on the fixed asset listing and did not have a fixed asset number attached. A computer terminal was not in use and apparently obsolete. In addition, there were no documents supporting DEED's ownership of a photocopier located in the department. DEED staff indicated that the photocopier had been transferred from the Crime Control Planning Board when it was incorporated in the former department. However, inventory records did not identify this transfer.
- We noted that the Division of Science and Technology had obtained some donated office furniture. In addition, at least one employee of the department was using his own personal computer and printer. Neither the donated items nor the personal property were properly recorded by the department.

Assets which are unmarked and/or are improperly recorded are especially susceptible to theft. Fixed asset records must be properly maintained for accuracy in financial reporting and to ensure that all assets are reviewed during inventories.

RECOMMENDATIONS:

4. *DEED should establish controls to ensure that all assets are properly identified and recorded on the inventory records in a timely manner.*
5. *The department should conduct periodic spot-checks of inventory and perform a complete physical inventory when records are determined to be inaccurate.*

DEED is not monitoring Economic Recovery Fund grants for compliance with certain provisions of applicable rules and grant agreements.

DEED administers two economic development grant programs: the Small Cities Development Set-Aside Program, funded through the federal Community Development Block Grant (CDBG) Program, and the state Economic Recovery Fund Grant Program. The Economic Recovery Grant Program was established through a \$6 million General Fund appropriation for fiscal year 1985.

These programs were designed to create new or retain existing jobs, to leverage new private investment and to enhance local tax bases through economic expansion. The State's Economic Recovery Grant funds are available to all general purpose units of government and recognized Indian Governments within the state. In accordance with Minn. Stat. Section 116J.873, the State's program is administered pursuant to rules adopted for the Small Cities Development Program.

DEPARTMENT OF ENERGY AND ECONOMIC DEVELOPMENT

DEED awarded 34 grants in fiscal year 1985. Our review indicated that DEED was not monitoring grantees for compliance with two conditions specified in the grant agreements. Minnesota Rule 4300.3100 Subp.2B provides that each grant agreement must contain the condition that five percent of the grant award will not be paid until successful completion of all activities in the work program. DEED had not retained the required five percent for various of the grants reviewed. Department staff indicated that they were not monitoring this provision and were considering seeking a rule change.

Grant agreements also specify any cost-sharing or local match requirements which must be met by grantees prior to requesting funds. Certain of the grants tested were not funded according to the indicated cost-sharing ratios. Currently, the payment requests do not contain a breakdown of the expenditures by funding source, although this information is included on the quarterly progress report submitted by each grantee.

RECOMMENDATION:

6. *DEED should establish controls to monitor payments to grantees to ensure compliance with grant agreement provisions for disbursement of funds.*

The purpose of the Business License Revolving Fund should be determined.

Laws of 1981, Chapter 342, Article 3, Section 16 established a business license revolving fund. Agencies issuing business licenses were required to deposit into the account the lesser of two percent of the license fee or \$10.00 until June 30, 1982 and the lesser of one percent of the fee or \$10.00 thereafter. Section 17 of the Laws provided that funds deposited in the business license revolving fund should be transferred to the General Fund in an amount not to exceed \$450,000 for the biennium ending June 30, 1983. The transfer was apparently intended to at least partially reimburse the General Fund for a \$450,000 appropriation made to the Bureau of Business Licenses for implementation of various duties assigned in Chapter 342.

During the biennium ending June 30, 1983, receipts totaling approximately \$45,000 were transferred from the revolving account to the General Fund. The surcharge continues to be collected, though there is currently no designated use for the funds. From July 1, 1983 through January 31, 1986, \$66,157 had accumulated in the account. DEED has no authority to expend or transfer the funds and has not been monitoring the account.

RECOMMENDATION:

7. *DEED should work with the Department of Finance to seek legislative clarification of the purpose of the business license revolving account and determine the appropriate disposition of the account balance.*



MINNESOTA Department of Energy and Economic Development

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St. Paul, Minnesota 55101

April 23, 1986

Mr. James R. Nobles
Legislative Auditor
Office of the Legislative Auditor
Veterans Service Building
St. Paul, Minnesota 55155

Dear Mr. Nobles:

Thank you for the opportunity to review the draft management letter based upon your financial and compliance audit work at the Department of Energy and Economic Development for the fiscal years 1984 and 1985. I appreciate the opportunity to prepare a response for inclusion in the final management letter. My response will focus on your comments and recommendations contained in Section II of your audit report.

I will respond to your comments and recommendations in the same order as which they appear in your report.

POLICIES AND PROCEDURES TO CONTROL PROMOTIONAL EXPENDITURES

Response to Comments

Your discussion of this issue notes that DEED has "generally followed established procurement and expense reimbursement guidelines," even though Minnesota Statutes exempt us from those guidelines for certain expenditures. I have always been a strong advocate of the use of competitive bidding procurement procedures by all public entities. Our Department firmly adheres to the Department of Administration's guidelines for competitive bidding. Not only do such procedures guard against potential abuses of public funds, they also increase the cost effectiveness and efficiency of the entire public sector.

When procuring equipment and supplies for use by our agency, DEED has rarely deviated from the Department of Administration's competitive bidding procurement guidelines. Only the Office of Tourism has made use of the department's exemption from these guidelines found in Minnesota Statutes Section 116J.60. This statute exempts our department from these guidelines for expenditures related to the promotion of tourism and economic

development. The Office of Tourism has used this authority for participation in sport shows, planning and implementation of the Governor's Fishing Opener, and the sponsorship of tourism conferences and programs which will help further the overall image and marketing of Minnesota as a travel destination. All of these uses can be documented by the department and are clearly in line with our promotional exemption found in statutes.

Your discussion of general expenditure controls notes that DEED does not clearly document the purpose for travel involving charter aircraft. Although this documentation is available in our agency files, we often did not attach it to the invoice. This shortcoming will be corrected in the future.

You also note that DEED did not always take advantage of a 10 percent discount on the cost of chartered aircraft for prompt payment of invoices. While this is true, the instances where a discount was not taken occurred most frequently in fiscal year 1984. At that time, DEED's Fiscal Services Operation fell far behind in its payment of certain invoices, partially as a result of the confusion caused by the reorganization of the department. Our Fiscal Services Operation during fiscal years 1985 and 1986 has improved substantially under our new director, and these available discounts are almost always taken. In fact, for the past 14 months, DEED has been recognized by the Department of Finance as having paid at least 98 percent of all its invoices within 30 days, a remarkable record for any public or private organization.

Response to Recommendations

DEED agrees with your recommendations regarding the development of internal policies and procedures to control promotional expenditures. While DEED rarely deviates from Department of Administration procurement and contracting guidelines, we shall develop more explicit, formal internal policies describing when we may use our statutory exemption (M.S. 116J.60) from these guidelines. We will develop these formal internal policies and adhere to them in the future.

DEED also agrees with your recommendation that we document the purpose for, and passengers on, all charter aircraft services along with the invoices for those services. We have already begun compiling this documentation. We will continue to do this in the future.

DEED also fully agrees with your recommendation that we institute procedures to ensure that all available discounts are taken. We are currently making every effort to do so and I believe recent records demonstrate that we have been successful.

DEED'S CONTROLS ON ITS FIXED ASSET INVENTORY

Response to Comments

DEED agrees with your comments that our fixed asset inventory control procedures are lacking. As noted in your report, the primary cause of our problems with fixed asset inventory controls relate back to our agency's reorganizations in 1981 and 1983. When these reorganizations were implemented, extreme care was not taken to document the distribution of fixed assets among the affected agencies.

Response to Recommendations

DEED clearly recognizes that this is a problem area. We will begin to rebuild our inventory control procedures and keep it up to date. Realizing that this task will be a major undertaking, our department will begin working with the Department of Administration and the State Planning Agency in an effort to determine the ownership of each agency's fixed assets. We will establish controls to ensure that all fixed assets are properly identified and recorded on the inventory records in a timely manner. After inventory records are updated, a physical inventory will be completed and procedures will be developed for a periodic spot-check thereafter.

With the department anticipating some additional physical movements over the next few months, we will begin to establish inventory control procedures. After this process is completed, we will then conduct a complete physical inventory. We are currently attempting to determine how to staff this complex project, provide for proper training, and develop a good system that will continue to be effective.

**DEED'S MONITORING
OF ECONOMIC RECOVERY FUND GRANTS**

Response to Comments

Your comments regarding DEED's failure to monitor its economic recovery grants for compliance with our rules and grant agreements are very helpful. The federal and state economic recovery fund grant programs are fairly new and their implementation, as with the implementation of most new programs, has taken some time to perfect. While we have made significant progress in developing proper procedures for monitoring these programs, our compliance with those procedures has been lacking.

It is essential to note that our failure to monitor the economic recovery programs for strict adherence to administrative rules in no way should imply that these programs have not been effective in achieving their statutory mandates. In fact, the success of these programs can be documented by the scores of individual businesses which owe their existence or expansion in Minnesota to the availability of these state and federal funds for economic development purposes.

You also comment that DEED staff questioned the need for an administrative rule requiring that five percent of all grants be withheld until all activities in the project workplan are successfully completed. While the staff may disagree with this rule, they should continue to monitor projects for compliance to it as long as it is part of our administrative rules. DEED will be further evaluating this particular rule to determine if it does warrant reconsideration. If our evaluation indicates the rule should be abolished, we will begin the process to amend our administrative rules.

Response to Recommendation

DEED agrees with your recommendation that we establish more effective procedures to monitor payments to Economic Recovery Fund grantees to ensure compliance with grant agreement provisions. While we may be seeking a rule change on the withholding of five percent of a grant until all activities in the project workplan are successfully completed, we will

continue to adhere to, and monitor, this provision until an amendment is formally adopted.

BUSINESS LICENSE REVOLVING FUND

Response to Comments

DEED agrees with your comments that a legislative clarification of the purpose for, and disbursement of, the Business License Revolving Fund be sought.

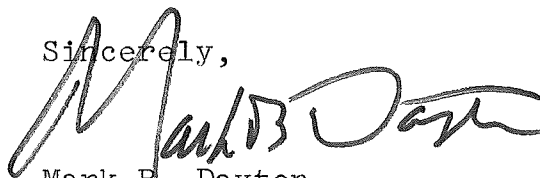
Response to Recommendation

DEED will bring the Business License Revolving Fund issue to the attention of the 1987 legislature and seek a legislative solution to this problem.

I appreciate the work your office has done and the recommendations you offer. I wish to compliment you and the people in your office who worked on this audit for your professionalism, courteous conduct in working with our staff, and constructive recommendations. These recommendations will assist us in improving further our management of this agency.

With best regards.

Sincerely,

A handwritten signature in black ink, appearing to read "Mark B. Dayton". The signature is fluid and cursive, with the first name "Mark" being the most prominent.

Mark B. Dayton
Commissioner

MBD:ltm