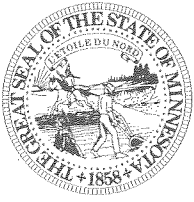

**STATE UNIVERSITY SYSTEM
OFFICE OF THE CHANCELLOR
FINANCIAL AND COMPLIANCE AUDIT
FOR THE THREE YEARS ENDED JUNE 30, 1985**

JULY 1986

**Financial Audit Division
Office of the Legislative Auditor
State of Minnesota**



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

Dr. Jon Wefald, Chancellor
State University System

Members of the State University Board

Audit Scope

We have completed a financial and compliance audit of the State University System Office of the Chancellor for the three fiscal years ended June 30, 1985, except for those programs and activities further described in the Scope Limitations section of this letter. Section I provides a brief description of the Chancellor's Office 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 April 29, 1986.

The objectives of the audit were to:

- study and evaluate major State University System Chancellor's Office internal accounting control systems, including a review of receipts, payroll, administrative and grant disbursements, imprest cash, and the tax sheltered annuity program;
- verify that financial transactions were made in accordance with applicable laws, regulations, and policies, including Minn. Stat. Chapter 136, State University Board policies and procedures, and other finance-related laws and regulations;
- evaluate the recording and reporting of financial transactions on the statewide accounting system; and
- determine the status of prior audit recommendations.

Th State University System is made up of seven state universities for which the Chancellor's Office provides management and support services. Audit coverage of the universities is performed separately on a periodic basis and is not included in the scope of this examination.

Senator Randolph W. Peterson, Chairman
Members of the Legislative Audit Commission
Dr. Jon Wefald, Chancellor
Members of the State University Board
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The management of the Chancellor's Office is responsible for establishing and maintaining a system of internal 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 authorizations.

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

Scope Limitation

We did not audit the State University System Revenue Bond Fund. The Revenue Bond Fund was audited by a private CPA firm for fiscal years 1983 through 1985. The Revenue Bond Fund audit workpapers are reviewed each year as part of our annual audit of the state's comprehensive financial report.

Conclusions

In our opinion, except for those issues raised in Section II recommendations 2 and 3, and except for the Revenue Bond Fund which we did not audit as described in the Scope Limitation section of this letter, the State University System Chancellor's Office system of internal accounting control in effect as of February 28, 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 authorizations.

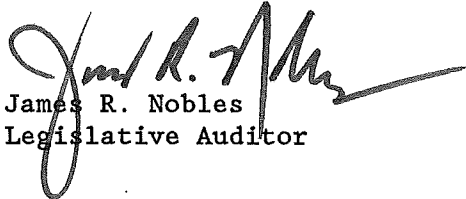
In our opinion, for the three years ended June 30, 1985, subject to the effects, if any, of Section II recommendation 1 and except for the Revenue Bond Fund which we did not audit, the Chancellor's Office administered its programs in compliance, in all material respects, with applicable finance-related laws and regulations.

Senator Randolph W. Peterson, Chairman
Members of the Legislative Audit Commission
Dr. Jon Wefald, Chancellor
Members of the State University Board
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In our opinion, for the three years ended June 30, 1985, the Chancellor's Office properly recorded, in all material respects, its financial transactions on the statewide accounting system.

The recommendations included in this audit report are presented to assist the Chancellor's Office in improving accounting procedures and controls. We will be monitoring and reviewing Chancellor's Office progress on implementing these recommendations. A summary of the progress made on all audit recommendations discussed in our last audit report covering the year ended June 30, 1982, dated July 27, 1983, is shown in Section III entitled, "Status of Prior Audit Recommendations and Progress Toward Implementation."

We would like to thank the Chancellor's Office staff for their cooperation during this audit.


James R. Nobles
Legislative Auditor


John Asmussen, CPA
Deputy Legislative Auditor

June 24, 1986

STATE UNIVERSITY SYSTEM
OFFICE OF THE CHANCELLOR

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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
Jeanine Leifeld, CPA	Audit Manager
Tony Toscano	Audior-in-Charge
Beth Widstrom-Anderson	Auditor
Judy Holthusen	Auditor

EXIT CONFERENCE

The findings and recommendations in this report were discussed with the following staff of the State University System Office of the Chancellor on May 5, 1986:

Nick LaFontaine	Associate Vice Chancellor, Finance
Roger Larson	Investment Manager
Mary Stanton	Staff Associate, Contract Management
Darla Sassor	Senior Accounting Supervisor

STATE UNIVERSITY SYSTEM

OFFICE OF THE CHANCELLOR

INTRODUCTION

The State University System is under the supervision and control of a ten member State University Board. The Board is responsible for the academic and fiscal management of the seven state universities. Nine members of the Board are appointed by the Governor, and the State Commissioner of Education serves as an ex-officio member. The Board appoints presidents and faculty, establishes salaries, prescribes courses of study, grants degrees, and adopts rules and policies for the universities. The Board also appoints a chancellor, who serves as chief executive officer of the State University System and who is accountable to the Board for the administration of the system.

The Office of the Chancellor provides management and support services for the daily operations of the State University System. These services include administrative data processing, budget development, accounting, payroll, procurement, and publications. Expenditures made by the Office of the Chancellor for general operations during the audit period were: \$3,576,878 for fiscal year 1983, \$5,037,328 for fiscal year 1984, and \$6,573,069 for fiscal year 1985. Dr. Jon Wefald served as chancellor during the period covered by this audit.

STATE UNIVERSITY SYSTEM

OFFICE OF THE CHANCELLOR

II. CURRENT FINDINGS AND RECOMMENDATIONS

The Chancellor's Office's responsibilities under Minn. Stat. Section 136.55 needs to be clarified.

The Chancellor's Office administers a tax sheltered annuity program for employees as authorized in Minn. Stat. Section 136.55, Subd. 1 which provides:

"At the request of an employee the state university board may negotiate and purchase an individual annuity contract from a company licensed to do business in Minnesota for an employee for retirement or other purposes and may allocate a portion of the compensation otherwise payable to the employee as salary for the purpose of paying the entire premium due or to become due under such contract. The allocation shall be made in a manner which will qualify the annuity premiums, or a portion thereof, for the benefit afforded under section 403(b) of the current federal internal revenue code or any equivalent provision of subsequent federal income tax law."

State University System employees authorize payroll deductions to be used for the purchase of tax sheltered annuities. The Chancellor's Office sends these deductions to annuity providers which were chosen by the individual employees. Fiscal year 1985 payments to providers on behalf of employees totaled \$5,478,211.

The Chancellor's Office does not monitor program compliance with the IRS code. They do not review employee-chosen annuity providers to make sure that plans qualify under IRS rules. They also do not make sure that employee contributions fall within IRS limits and that annuity changes are allowable. Although The Chancellor's Office cannot know about any additional plans the employees might belong to, they are in a position to monitor the program they administer. The position of the Chancellor's Office staff is that they are not responsible for this monitoring. To clarify this with employees, the Chancellor's Office intends to notify participants that the responsibility for calculating the maximum annual contribution limit as well as monitoring allowable changes to the tax sheltered annuity deduction rests with each participant.

The statutes do not clearly specify whether the Chancellor's Office is responsible for monitoring employee tax sheltered annuity plans for compliance with the IRS code. We are concerned that the Chancellor's Office could experience future problems should participants find that all or part of their sheltered annuity deductions are unallowable. By obtaining an opinion from the Attorney General on their responsibilities under Minn. Stat. Section 136.55, the Chancellor's Office could help avoid any future problems.

STATE UNIVERSITY SYSTEM

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RECOMMENDATION:

1. *The Chancellor's Office should obtain an Attorney General's opinion concerning their responsibilities for monitoring the tax sheltered annuity program under Minn. Stat. Section 136.55.*

The Chancellor's Office is not enforcing contract requirements relating to travel payments on contracts for professional services.

The Chancellor's Office contracts for various professional services, both for general operations and in carrying out programs funded by a Bush Foundation grant. Consultant and professional services disbursements for fiscal year 1985 for general operations and Bush Foundation Grants were about \$94,000.

Professional services contracts generally include two payment amounts, one for services and another specific amount to be used for travel and subsistence reimbursements. Contract terms usually require that all travel reimbursements be made according to the same guidelines as those established for state employees by the Department of Employee Relations (DOER). DOER guidelines require that transportation reimbursement requests include the purpose and mileage for each trip. They also require that all subsistence requests be documented and, except for meals and taxi services, be accompanied by receipts. The guidelines also set maximum amounts allowable for certain types of expenses.

Five general operations and Bush Grant contracts which we tested included provisions for travel and subsistence reimbursements. In every case, the vendor involved received the full amount allowed for travel, although in four of the instances the travel expenses were not documented as required by the terms of the contract. In one case, an amount designated as travel and subsistence in the contract was used to pay for word processing costs. The Chancellor's Office paid a total of \$2,718 for travel and subsistence expenses that were not documented.

By not requiring documentation for travel and subsistence payments, the Chancellor's Office cannot assure itself that it is only paying for actual travel and subsistence expenses incurred by the vendor.

RECOMMENDATION:

2. *The Chancellor's Office should enforce contract provisions requiring contract vendors to fully document travel and subsistence reimbursement claims.*

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The Chancellor's Office is not properly recording compensatory time earned and taken by its employees.

State employees covered by certain bargaining units are eligible to receive compensatory time off. Compensatory time off is earned only when an employee works hours in addition to the normal eighty hours in a pay period.

One employee tested had recorded compensensatory time earned on his time sheet. However, there was no approved request for compensatory time on file nor was the compensatory time recorded in either the manual leave records maintained by the Chancellor's Office or the automated state payroll system. Also, in a subsequent pay period when the employee used some of his compensatory time, the hours were entered into the system as regular hours.

The bargaining agreement covering the employee states:

"Employees may receive overtime at the rate of straight-time when assigned to a special work assignment which is in addition to their normal job duties and upon having received advance approval from their Appointing Authority. Such overtime may be liquidated either in cash or compensatory time off at the option of the Appointing Authority who shall consider the desires of the employee. Employees are eligible for overtime only after completing eighty (80) hours work in a pay period."

In addition, payroll operating procedure 07:04:23 states:

"Each state employee must initiate a written request for personal leave. Whenever possible, this request should be made in advance of the leave. If advance approval is not possible, the request should be submitted to the supervisor promptly upon the employee's return to work."

Because there are no records documenting compensatory time earned and taken, we were unable to determine the extent of the problem. However, by not formally authorizing and recording compensatory time earned and taken, the controls over compensatory time become severely limited. In fiscal year 1985, payroll expenditures made out of the Chancellor's Office's maintenance and equipment account totaled \$1,395,944 or about 20 percent of expenditures from that account. Strong controls over compensatory time would ensure that employees are entitled to all the compensatory time they are using.

RECOMMENDATION:

3. *The Chancellor's Office should require that requests for compensatory time be formally approved in advance and that all compensatory time earned be recorded on the payroll system.*

STATE UNIVERSITY SYSTEM

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STATUS OF PRIOR AUDIT RECOMMENDATIONS
AND
PROGRESS TOWARD IMPLEMENTATION

Payments from the Revenue Bond Fund to the maintenance and equipment account for the reimbursement of fuel and utility costs are not made on a regular basis.

1. Written procedures should be developed specifying the method to be followed when reimbursing the maintenance and equipment account from the Revenue Bond Fund for fuel and utility costs. Payments should be made on a regular basis from the Revenue Bond Fund.

Recommendation Implemented. The Chancellor's Office made the fiscal year 1984 and 1985 fuel and utility reimbursements on a quarterly basis. However, we believe that all other payments from the Revenue Bond Fund should also be made on a regular basis.

Lease payments from the Revenue Bond Fund to the Board Office are not being made in accordance with the lease agreement.

2. Payments from the Revenue Bond Fund to the State University System for the rental of housing should be made as specified in the lease agreement.

Recommendation Implemented. The Chancellor's Office made all fiscal year 1984 and 1985 lease payments as required by the lease agreement.

Internal controls over disbursements at the Board Office need improvement.

3. The Board Office should require that all invoices submitted by the universities to the Board Office for payment be signed by an authorized person as proof that the goods or services have been received. The person signing the invoice should be a person authorized to receive the items being delivered and also independent of the purchasing duties at the university. Approved invoices should be compared to purchase orders prior to actual payment by the Board Office.

Recommendation Implemented. Testing during this audit showed that invoices are now being properly approved.

4. Someone independent of the purchasing function at the Board Office should be authorizing all batch cover sheets before entering these invoices for payment.

Recommendation Implemented. Beginning in November 1984, the Chancellor's Office accounting supervisor began reviewing in detail all payments made and signing the batch cover sheet.

STATE UNIVERSITY SYSTEM

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There is no report currently being prepared for the Legislature summarizing the activity in the expense account.

5. The Board Office should require each university to submit the necessary information on expenditures made from the miscellaneous expense account. The Board Office should then prepare a combined report for the State University System and submit it to the Legislature as required by the statute.

Recommendation Implemented. The required report was filed on November 15, 1984.

Unclassified non-faculty employees of the state universities are not preparing positive time reports.

6. The Board Office, in conjunction with the state universities, should work with the DOER to establish an acceptable positive time reporting system for all non-faculty employees of the State University System. Forms used should be approved by the DOER.

Recommendation Implemented. On April 30, 1985, the Chancellor's Office issued a memorandum to all university personnel directors outlining an acceptable time reporting system for unclassified non-faculty employees.

The extent to which the state may legally provide services for the benefit of certain private foundations and the appropriate degree of financial reimbursement for any allowable services is unclear.

7. The Board Office should work with the Attorney General's office to determine whether it is permissible for the state universities to perform accounting and other services for the private foundations. If these services are allowed, the universities should be compensated by the foundations for the time and expenses incurred. The terms and conditions agreed upon should be specified in writing and be approved by the proper officials.

Recommendation Implemented. The Chancellor's Office received a memo from the Attorney General's Office dated January 18, 1982, stating that it is permissible for state universities to perform accounting and other services for the private foundations. The state universities now have contracts with their related foundations outlining the responsibilities of each.

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PHONE 612/296-2844

SUITE 230/PARK OFFICE BUILDING/555 PARK STREET, ST. PAUL, MINNESOTA 55103

June 24, 1986

Jeanine Leifeld
Audit Manager
Office of the Legislative Auditor
Veterans Service Building
St. Paul, MN 55155

Dear Ms. Leifeld:

Thank you for the opportunity to review and respond to the findings resulting from your recent examination of the operations of my office. Such reviews are always helpful and this one is especially timely in light of my eminent departure. I'm sure my successor will take comfort in knowing that the financial operations of this office have been recently reviewed and found to be in substantial compliance with applicable regulations and guidelines.

With respect to the specific recommendations in your report, we respond as follows:

1. "The Chancellor's Office should obtain an Attorney General's opinion concerning their responsibilities for monitoring the tax sheltered annuity program under Minn. Stat. Section 136.55."

We concur with the recommendation and we have formally requested an opinion from the Attorney General as evidenced by the attached memo. Nick LaFontaine has been assigned responsibility following through on this item.

2. "The Chancellor's Office should enforce contract provisions requiring contract vendors to fully document travel and subsistence reimbursement claims."

We concur with the recommendation. We are instituting procedures which start with informing the contractor of the necessity to completely and accurately document all claims for travel reimbursement and ending with the verification of such claims prior to disbursing any funds. Darla Sassor is responsible for implementing corrective action.

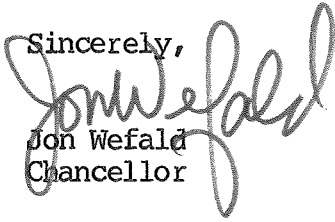
3. "The Chancellor's Office should require that requests for compensatory time be formally approved in advance and that all compensatory time earned be recorded on the payroll system."

Jeanine Leifeld
June 24, 1986
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We concur with the recommendation. All requests for compensatory time must now be approved by the individual's supervisor and the Director of Labor Relations and Personnel. Approved requests will be recorded on the payroll system. Nick LaFontaine is responsible for implementing appropriate corrective action.

Let me once again thank you and your staff for your efforts and commend you on the professional manner in which you conduct your reviews. If you have any questions regarding our response, please feel free to call.

Sincerely,



Jon Wefald
Chancellor

cc:
Ed McMahon
Nick LaFontaine
Roger Larson
Darla Sassor

Chen

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PHONE 612/296-2844

SUITE 230/PARK OFFICE BUILDING/555 PARK STREET, ST. PAUL, MINNESOTA 55103

June 23, 1986

Memo To: Charles Mottl

From: Nick LaFontaine

Subject: Responsibilities under MS 136.55

The Office of the Legislative Auditor recently completed an examination of our procedures and has raised the question of the responsibilities of the Chancellor's office under MS 136.55 Subd. 1 which provides:

"At the request of an employee the state university board may negotiate and purchase an individual annuity contract from a company licensed to do business in Minnesota for an employee for retirement or other purposes and may allocate a portion of the compensation otherwise payable to the employee as salary for the purpose of paying the entire premium due or to become due under such contract. The allocation shall be made in a manner which will qualify the annuity premiums or a portion thereof, for the benefit afforded under section 403(b) of the current federal internal revenue code or any equivalent provision of subsequent federal income tax law."

I have attached a copy of a letter recently sent to each TSA participant and a copy of a letter sent to each TSA carrier. These letters set forth the parameters under which the Chancellor's office operates the TSA program enabled by MS 136.55.

I am requesting that you assess the responsibilities of the Chancellor's office under MS 136.55 and that you formally advise us of your assessment so that we may share it with the Office of the Legislative Auditor.

If you require additional information, please feel free to call.

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SUITE 230/PARK OFFICE BUILDING/555 PARK STREET, ST. PAUL, MINNESOTA 55103

April 25, 1986

Memo to: TSA Carriers

From: Nick LaFontaine
Associate Vice Chancellor for Finance

Subject: Operational Review

As you know from prior correspondence, we recently engaged the firm of Touche Ross & Co. to review our handling of the Tax Sheltered Annuity program with respect to compliance and efficiency. While they found no substantive problems, they made some recommendations for improving our capacity to serve the TSA participants. We are also corresponding with each participant and I am enclosing a copy of that letter for your information.

I will merely refer you to the attached memo for our position on the calculation of the maximum annual contribution and the processing of changes to the agreement. I do want to elaborate on the changes we will be instituting regarding the number of participants necessary to remain a "qualified" carrier. The study highlighted the fact that 90% of the Carriers currently active have less than twenty five participants. We believe this seriously detracts from our ability to effectively serve the vast majority of our participants. We have established twenty five as the minimum number of participants necessary to become and remain a qualified Carrier. Therefore, we will neither add new Carriers unless they have contracts with at least twenty five employees nor will we allow current Carriers with less than twenty five participants to add employees unless the

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April 25, 1986

Memo to: Tax Sheltered Annuity Participants

From: Nick LaFontaine *Nick*
Associate Vice Chancellor for Finance

Subject: TSA Services

We recently commissioned the firm of Touche Ross & Co. to conduct an operational audit of our handling of the Tax Sheltered Annuity program. Specifically, we asked Touche Ross to examine our procedures in respect to compliance with applicable IRS regulations and in respect to operating efficiencies. This communication results, in part, from their work.

As I'm sure you are all aware, the Tax Sheltered Annuity (TSA) program is only one of the capital accumulation plans available to you. The Tax Sheltered Annuity program administered by our office is covered by Section 403(b) of the Internal Revenue Code (IRC or Code). We have received some requests recently to make contributions to plans covered by other provisions of the Code which we have had to deny. We can make contributions on your behalf only to plans covered by Section 403(b) of the Code.

For your information, the Minnesota State Retirement System (MSRS) administers a Deferred Compensation plan. You are eligible to participate in this plan through payroll deduction. You should be aware that if you participate in the Deferred Compensation plan and a TSA plan the total contributions to these plans must be considered when calculating the maximum annual limit (see next paragraph). You are also eligible to establish an Individual Retirement Account (IRA). However, there is no provision for funding an IRA through payroll deduction.

Several IRC Sections and regulations may have bearing in calculating the maximum annual contribution limit for you under the TSA provisions. You are the only source of all of the information necessary to make the calculation. No one at the University or the Chancellor's office is empowered to calculate for or give advice or guidance to employees or agents in the calculation of the maximum annual contribution limit. As you are undoubtedly aware, tax deferred retirement plans are under examination as a new tax bill is being formulated. As noted above, there already exists linkage of contributions of TSA and other deferred compensation plans under the current law and this is likely to be expanded in the future. Each participant is advised to carefully review his/her situation with a professional tax advisor.

Participants
April 25, 1986
Page 2

The IRC limits the number of changes to the TSA deduction agreement to one per taxable year. As with the maximum contribution limit, we believe you are the only one in possession of all the facts necessary to determine whether you made the one permissible change allowed under the Code. Therefore, consistent with past practice, the responsibility for monitoring the number of changes made in any taxable year rests with the employee. You are advised that the IRS may, upon audit, disallow any contributions made to your TSA account after processing the second change in the taxable year in question. We will continue to have open enrollment periods in April and September of each year, however.

The operational recommendations of Touche Ross relate to streamlining our processing to ensure that we transmit your TSA contributions to the Carrier as quickly as possible. We have already instituted one of the recommendations and are studying another recommendation to determine the best implementation method. So that you may know our processing schedule, we have established five working days as the deadline for accumulating your contribution with others for the same Carrier and forwarding the total amount due to the Carrier. Stated another way, within one calendar week of payday we have sent your contribution to the designated Carrier(s). We are pleased to report that we have recently been able to forward participant contributions to the Carrier within 4 to 5 days of the payday.

Finally, the review highlighted the fact that we are currently servicing many Carriers that have fewer than twenty five participants. Clearly, this detracts from our ability serve the majority of participants. We have established twenty five participants as the minimum number of participants required before we will accept a new Carrier. We will continue to carry all current participants with the Carrier they have designated so no one will be affected unless a change to a new, or "unqualified" Carrier is requested.

We believe the external examination was informative and helpful. The changes we intend to incorporate should enable us to better serve the more than sixteen hundred TSA participants in the Minnesota State University System.