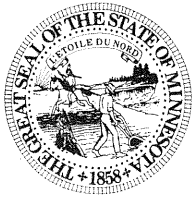

**DEPARTMENT OF ENERGY AND
ECONOMIC DEVELOPMENT
MANAGEMENT LETTER
FISCAL YEAR 1986**

FEBRUARY 1987

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

Mr. David Speer, Commissioner
Department of Energy and Economic Development
900 American Center Building
150 East Kellogg Blvd.
St. Paul, Minnesota 55101

Dear Commissioner Speer:

We have reviewed certain accounting procedures and controls for your department as part of our statewide audit of the State of Minnesota's fiscal year 1986 financial statements and federal programs. The scope of our work has been limited to:

- those aspects of your department which have a material impact on any of the state's various funds and account groups shown on the financial statements;
- the Community Development Block Grant Program (CFDA #14.228) included in our Single Audit scope; and
- the status of prior audit recommendations.

We emphasize that this has not been a complete financial and compliance audit of all programs within your department. The work conducted in your department is a part of our annual statewide audit and federal compliance audit (Single Audit). The Single Audit coverage satisfies the federal government's financial and compliance audit requirements for all federal programs administered by your department in fiscal year 1986. The federal government is ultimately responsible for determining resolution of Single Audit recommendations and the appropriate federal program agency will contact your agency to review your efforts toward corrective actions for 1986 and prior years. They will also notify you of their final resolution.

This management letter contains both the recommendations developed during this audit and a reiteration of a prior recommendation which has not yet been fully implemented. Attached to your management letter is a summary of the progress on all audit recommendations developed during our 1985 statewide audit.

The recommendations included in this letter are presented to assist you in improving accounting procedures and controls. Progress on implementing these recommendations will be reviewed during our audit next year.

PRIOR RECOMMENDATIONS PARTIALLY IMPLEMENTED: The administration of subgrants awarded under the Community Development Block Grant Program (CFDA #14.228) should be improved.

DEED awards subgrants from the Community Development Block Grant (CDBG) Program to local units of government in the state. The funds are to be used to enhance local communities by providing a suitable living environment and expanding economic opportunities, principally for persons of low and moderate income.

DEED has made progress in administering the program by implementing three of four prior audit recommendations. DEED has developed a subgrantee monitoring plan which identifies the areas to review during a monitoring visit and the procedures to follow when reviewing each area. They have also developed a systematic method of identifying the grants scheduled for the various types of review and are documenting the monitoring visits by including the write-ups in the grant file along with a copy of the monitoring report that is sent to the subgrantee. DEED has also established procedures for review of subrecipient audit reports and for processing subrecipient grant refunds.

Although DEED has made progress in improving the administration of the CDBG projects, we did find certain problems during our current year testing. A control weakness identified in our fiscal year 1985 audit related to receipt and review of quarterly subgrantee reports. The grant agreements between the State of Minnesota and the local units of government require each subgrantee to submit quarterly reports to DEED within 25 days of the end of the quarter. Eight of the 52 subgrants tested were missing at least one of the required quarterly reports. Additionally, documentation was not available to indicate that reports were reviewed as received. For 45 of the 52 grants tested, documentation supporting at least one required review of quarterly reports was missing. The quarterly reports include a variety of information such as the status of funds and progress made on the project to date. Because these reports are used as a management tool and could identify any problem areas that would be the basis for an on site monitoring visit, it is important that they are received and reviewed on a timely basis. A monitoring system to ensure that the reports are reviewed for reasonableness should be developed and utilized.

Another area of concern found during our current audit relates to the timing of payments to subrecipients and the extension of grant contracts. DEED is responsible for properly reimbursing subgrantees for costs incurred during the approved grant period. Six of the 52 subgrants tested requested a total of \$51,513 for costs relating to dates after the end date specified in the subgrant contract. Costs incurred after the approved grant expiration date are ineligible costs. According to the Small Cities Development Program procedures relating to grant period extensions, either the subgrantee or DEED may request the extension of grant dates. We found no evidence of approved grant extensions for the six subgrants in question. When payment request forms are received at DEED the grant end dates are not reviewed to ensure that the payments are made for costs incurred within the approved grant period.

DEED is currently planning to change from a quarterly subgrantee reporting requirement to semi-annual reporting, in part to enable the staff to more fully complete the review process. When implemented, the number of reports received will be decreased allowing DEED to review them in a more timely manner. DEED is also in the process of implementing a new computer system for use in administering CDBG subgrants. In addition to providing other information about subgrant activity, the system will be used to monitor receipt and timely review of performance and audit reports and to monitor grants to ensure that payments are not made for services after the end dates of the subgrantee contracts.

RECOMMENDATIONS:

1. DEED should ensure timely submission and review of quarterly reports from subrecipients.
2. DEED should develop controls to ensure that payments to subrecipients are made for eligible costs incurred within the approved grant period.

Time distribution records to support payroll charges to federal programs need improvement.

The state receives federal funding for administration of the Community Development Block Grant Program. The amount of federal money allowed for administration of the program is \$100,000 plus two percent of the total grant award. The state is required to match, on a 50/50 basis, the two percent administrative funds. Federal funds expended for administration during fiscal year 1986 totaled \$414,733. The largest component of the administrative expense category is for salaries.

Expenditures for payroll may be charged to allowable federal programs either directly or indirectly. According to U. S. Office of Management and Budget Circular A-87:

"Amounts charged to grant programs for personal services, regardless of whether treated as direct or indirect costs, will be based on payrolls documented and provided in accordance with generally accepted practice of the state, local, or Indian tribal government. Payrolls must be supported by time and attendance or equivalent records for individual employees. Salaries and wages of employees chargeable to more than one grant program or other cost objective will be supported by appropriate time distribution records. The method used should produce an equitable distribution of time and effort."

Some employees who work on the Community Development Block Grant (CDBG) Program (CFDA #14.228) may also work on other community development programs which are funded from state appropriations. In September 1986, the Minneapolis-St. Paul Regional Office of the U.S. Department of Housing and Urban Development issued a report on the results of their monitoring review of the CDBG Program in Minnesota. Their report found that "Certain salaries being directly charged to the CDBG program are not based on payrolls which accurately reflect time spent on the CDBG program. Certain staff have been directed to ensure their payroll records reflect that 25 percent or 50 percent of their time is spent on the CDBG program."

In our fiscal year 1983 audit of DEED, we questioned the procedures used for allocating payroll charges to federal programs. At that time, the majority of staff were not identifying the programs on which they worked each pay period. Following that audit, DEED revised their procedures and staff began identifying the various programs worked on. We reviewed

timesheets of all CDBG staff for two pay periods during fiscal year 1986. It appears that those employees who are split-funded are charging their time according to a predetermined schedule rather than the actual hours worked.

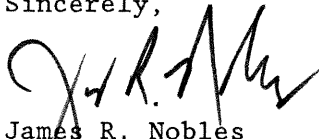
The allocation of hours recorded on the timesheets should be based on the actual hours worked on individual programs each pay period. The various federal agencies have approved different methods for allocation of time. The state's centralized payroll system has cost accounting capabilities which provide for direct allocation of salary charges based on actual hours worked. The department needs to implement and document a policy to distribute actual time worked to the appropriate programs.

RECOMMENDATION:

3. *DEED should institute procedures to allocate salary charges based on the actual hours worked on the various programs.*

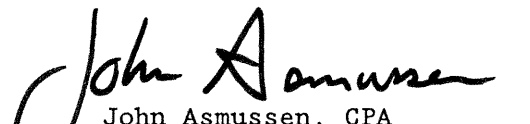
Thank you for the cooperation extended our staff during this audit.

Sincerely,



James R. Nobles
Legislative Auditor

Attachment



John Asmussen, CPA
Deputy Legislative Auditor

February 10, 1987

DEPARTMENT OF ENERGY AND ECONOMIC DEVELOPMENT

STATUS OF PRIOR AUDIT RECOMMENDATIONS
AND
PROGRESS TOWARD IMPLEMENTATION

The administration of subgrants awarded under the Community Development Block Grant Program (CFDA #14.228) should be improved.

1. DEED should develop procedures to ensure timely submission and review of quarterly reports and should withhold payments to subrecipients who do not comply with reporting requirements.

RECOMMENDATION NOT IMPLEMENTED. See current recommendation #1.

2. DEED should continue to develop procedures to ensure that adequate documentation is maintained for all reviews or monitoring visits completed.

RECOMMENDATION IMPLEMENTED. During fiscal year 1986, procedures were developed to document all reviews and monitoring visits.

3. DEED should inform all subrecipients of the requirements of the Single Audit Act of 1984 and should develop a system to monitor compliance with these requirements and to resolve any audit findings.

RECOMMENDATION IMPLEMENTED. A letter and OMB Circular A-128 were sent to all subrecipients on February 6, 1986. Procedures have also been implemented to review these A-128 audits as they are received.

4. DEED should work with the U.S. Department of Housing and Urban Development to develop appropriate procedures for processing subrecipient refunds.

RECOMMENDATION IMPLEMENTED. Procedures were prepared after being approved by HUD during fiscal year 1986.



MINNESOTA Department of Energy and Economic Development

Office of the Commissioner
(612) 296-6424

900 American Center
150 East Kellogg Boulevard
St. Paul, Minnesota 55101

February 10, 1987

Ms. Claudia Gudvangen
Audit Manager
Office of the Legislative Auditor
Veterans Service Building
20 West 12th Street
St. Paul, MN 55155

Dear Ms. Gudvangen:

Staff from the Department of Energy and Economic Development have reviewed your Management Letter of January 29, 1987 and have prepared responses for insertion in this formal response letter. As you requested, we have commented on each of your recommendations, identified the staff person responsible for implementing any procedural changes, and identified a tentative date for implementation of changes. Finally, I appreciate your acknowledgement that substantial program management improvements have occurred since your last audit.

For your convenience, I will respond to your concerns in the same order in which they were presented in your January 29th letter.

Finding #1

"Although DEED has made progress in improving the administration of the CDBG projects, we did find certain problems during our current year testing. A control weakness identified in our fiscal year 1985 audit related to receipt and review of quarterly subgrantee reports.

Recommendation:

1. DEED should ensure timely submission and review of quarterly reports from subrecipients."

DEED Response:

Quarterly subgrantee reports are neither a HUD nor an OLA requirement. Instead, quarterly reporting requirements were developed by DEED staff and are outlined in DEED's formal subgrantee project agreement. In fact, HUD staff warned that requiring quarterly progress reports could be excessively burdensome. "Quarterly reporting from your grantees may be a good idea in theory, but as the number of grantees grows and the number of SCDP staff remains constant, we would recommend that you rethink the process." HUD went on to recommend reducing the number of required progress reports. Moreover, other management techniques employed by SCDP staff also track grantee progress, including onsite monitoring, audit reviews, payment request reviews, and regular informal grantee contacts.

AN EQUAL OPPORTUNITY EMPLOYER



As you have stated, the SCDP is currently in the process of changing over from quarterly reporting to semi-annual reporting. The reports will be due at times conducive to thorough staff review. The changeover from quarterly reports to semi-annual reports will require project agreement amendments, but still should be completed by the end of February. Louis Jambois, the SCDP Director, will be responsible for this change.

Finding #2

"Six of the 52 subgrants tested requested a total of \$51,513 for costs relating to dates after the end date specified in the subgrant contract. Costs incurred after the approved grant expiration date are ineligible costs. According to the Small Cities Development Program procedures relating to grant period extensions, either the subgrantee or DEED may request the extension of grant dates.

Recommendation:

2. DEED should develop controls to ensure that payments to subrecipients are made for eligible costs incurred within the approved grant period."

DEED Response:

The time extension amendments required to reactivate the projects in question have been completed.

This finding stemmed primarily from recent turnover in the position charged to process grant payments (three different staff in a one-year span) and an imperfect internal payment process. Since the hiring and orientation of a professional financial analyst and the improvements that that individual has made in the internal payment process, there have been no payments on expired projects. Thus, in essence, the problem which created the finding has already been corrected. As you noted in your Management Letter, the new computer management system will assist us in this area by augmenting (for the short term, at least) the existing manual payment system. Bonnie Burt, Executive Assistant to the Deputy Commissioner, is responsible for managing the grant payment system.

Finding #3

"It appears that those employees who are split-funded are charging their time according to a predetermined schedule rather than the actual hours worked.

Recommendation:

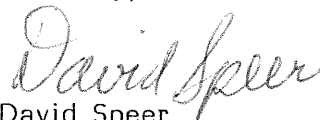
3. DEED should institute procedures to allocate salary charges based on the actual hours worked on the various programs."

DEED Response:

Beginning with each fiscal year, the Community Development Division analyzes the available funding for both state and federal sources and also reviews the available complement. The Division then attempts to allocate staff time to the respective state and federal budgets. Staff then work on both state and federal projects, based on actual time worked and are not specifically directed to ensure their payroll records reflect a predetermined percentage. We feel that as we continue to work with HUD, we will be better able to manage this area. We also have submitted a proposed cost allocation plan to HUD, which is designed to address the fundamental issue raised in this finding.

As stated in the exit conference, I would like to commend you and your staff for conducting a thorough, fair, and professional analysis of the SCDP program. If you have any questions about this letter, please contact Robert F. Benner at 297-2515.

Sincerely,

A handwritten signature in cursive script that reads "David Speer".

David Speer
Commissioner

/dh
I/18-CP & CP1