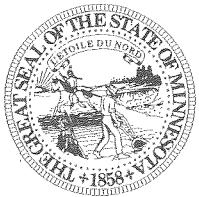


**DEPARTMENT OF ADMINISTRATION
MANAGEMENT LETTER
FISCAL YEAR 1986**

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

Ms. Sandra Hale, Commissioner
Department of Administration
208 Administration Building
St. Paul, Minnesota 55155

Dear Commissioner Hale:

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 was 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;
- your statewide functional responsibilities for procurement, contract management, and real estate management;
- a review of general data processing controls at the Information Management Bureau (IMB), including organization and operational controls, system development and documentation controls, access controls, hardware and system software controls, and data and procedural controls; 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. However, we are in the process of conducting a financial and compliance audit of your department and will issue a separate Audit Report in the spring of 1987. Even though no auditing of federal programs was done in your department during our fiscal year 1986 audit, the statewide single audit coverage still satisfies the federal government's financial and compliance audit requirements for all federal programs administered by your department in fiscal year 1986.

This management letter contains both our recommendations developed during this audit and reiteration of our prior audit recommendations which have not yet been implemented. Prior audit recommendations repeated in this text are denoted under the caption "PRIOR RECOMMENDATIONS NOT IMPLEMENTED" or "PRIOR RECOMMENDATIONS PARTIALLY IMPLEMENTED." Attached to your management letter is a summary of the progress made on all audit recommendations included in our fiscal year 1985 management letter dated February 18, 1986 and our management letter on general EDP controls dated March 11, 1986.

The current 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.

Financial difficulties have caused unpaid obligations and inconsistent accounting practices for certain revolving funds.

During fiscal year 1986 certain Administration funds experienced cash flow problems. Because many revolving funds use the goods or services of other revolving funds, an easy way to alleviate cash flow problems was to delay required payments to other Administration revolving funds. Although these amounts were properly accrued on the financial statements, the revolving funds were not complying with procedures requiring prompt payment of obligations.

The largest accruals to other funds resulting from cash flow problems involved the Computer Services (IMB) Fund which incurred a \$1.9 million operating loss for fiscal year 1986. IMB pays rent to the Plant Management Fund for building space rent. They also reimburse Plant Management for electricity used by IMB. Since Plant Management's cash position during fiscal year 1986 was good, IMB was allowed to defer half of their annual rent payments, or \$200,900 and electrical reimbursements of \$100,474. This did not comply with Department of Finance Policy and Procedure 06:09:07, which requires all agencies to pay monthly rent payments to Plant Management.

Another unpaid IMB obligation was for indirect costs owed to the General Fund for fiscal year 1986. Indirect costs totalling \$359,142 were not paid by June 30, 1986 as required.

IMB also attempted to improve their financial position by applying inconsistent fixed asset capitalization policies. IMB currently uses the Fixed Asset Records Management System (FARMS) capitalization policy which requires unit cost of at least \$300 and life expectancy of at least one year in order to capitalize an asset. However, during fiscal year 1986, computer tape cartridges, costing \$14.00 each, were capitalized. Thus, IMB would have been able to spread the expense of this purchase over five years, rather than expensing the entire amount in 1986 as required. This accounting change would have reduced IMB's operating loss by \$256,556. However, we prepared an audit adjustment so that the cost was properly recognized on the state's financial statements.

Another transaction originating from cash flow problems involved Central Stores and Resource Recovery. Since Resource Recovery was experiencing cash flow problems and Central Stores was in relatively good condition, Central Stores was required to purchase goods on consignment at a cost of \$5,475 from Resource Recovery. This transaction was not in the ordinary course of business and possibly would not have occurred had it not been for the existing cash needs of Resource Recovery.

Minn. Stat. Chapter 16A.126 establishes legal authority for a revolving fund to obtain a General Fund loan when there is not enough money in the revolving fund for an immediate necessary cash expenditure. By deferring required expenditure obligations, revolving funds have circumvented the

requirements of Minn. Stat. Chapter 16A.126. They have created a form of reliance on the cash position of the other revolving funds and are no longer operating independently.

RECOMMENDATION:

1. *Administration should work with the Department of Finance to determine when a General Fund loan should be obtained or if obligations between funds can be deferred to mitigate cash flow problems.*

COMPUTER SERVICES

The Information Management Bureau (IMB) is responsible for operating the state's central computers and coordinating all computer systems used with the state.

IMB should strengthen data security and access controls.

The Department of Administration is responsible for controlling access to the state computer systems and ensuring the integrity of computerized data. Minn. Stat. Section 16B.40, Subd. 8 provides:

"In consultation with the attorney general and appropriate agency heads, the commissioner [of Administration] shall develop, install, and administer a state data security system consistent with state law to assure the integrity of computer based and all other data and to assure confidentiality of the data, consistent with the public's right to know."

IMB employs two security officers and uses a computer software package, ACF2, to limit access to computer systems and data sets to only authorized personnel for appropriate uses. Access is limited through the use of logonIDs. LogonIDs are assigned to individuals by the IMB security officers based on signed authorization forms received from agencies. The security officers follow up any unauthorized access attempts reported by ACF2.

Data security, however, remains vulnerable because of certain control weaknesses. First, all agencies have not identified agency contacts authorized to approve logonID requests and pursue violation attempts. IMB sent a request to user agencies in August 1984 asking agencies to identify authorized agency contacts. However, many agencies did not respond and even for those who did respond, many of the assigned delegates have left state employment or changed positions since then. Without a current and complete authorization list, the IMB security officers may work with agency personnel not authorized to grant access to data or pursue violations. For effective control over system and data access, a process should be established to formally identify these agency contacts. In addition, a method for continually updating this list is necessary as staff change their employment status.

LogonIDs are protected by the use of a secret password established by the individual for which the logonID was created. Each logonID should be used immediately by the assigned user when it is created in order to establish password protection. However, many logonIDs are not protected when they are created and many currently remain unprotected. If a password has never been assigned, the logonID can be used by anyone. Many of these unprotected logonIDs have clearance to major IMB systems, and a few have the ability to enter payment transactions into the statewide accounting system. The IMB security officers have informed agencies about their logonIDs which have never been used. However, some agencies have permitted the unused logonIDs to remain. IMB must emphasize the risk of this practice to state agencies. We believe that IMB should suspend any logonIDs which remain unused after a reasonable time period.

Problems also occur when agencies have not notified the IMB security group of employees who have left state service or changed employment. If such an employee's logonID is not cancelled or suspended, the employee would continue to have access to the system. The Department of Finance has a system for identifying users of the statewide accounting system who have changed employment. The IMB security group uses that information. However, we believe that IMB should exert additional control over logonIDs.

Another control weakness exists over computer system output. Those who pick up output and tapes at IMB are not required to provide identification or authorization. IMB should identify individuals authorized to remove tapes and reports from the IMB output window. Output window personnel would have a list of authorized individuals for each agency. These individuals could be required to show an identification badge or to sign for the output. In addition, agencies should be required to identify which tapes can leave IMB and which tapes cannot.

Finally, access controls could be strengthened if all computer systems were subject to the controls exercised by the ACF2 software security package. Currently, a job scheduling system, UCC7, operates outside the ACF2 security controls. The company supplying UCC7 and the company supplying ACF2 are currently working together to make the UCC7 software package function within the ACF2 control system. IMB has not corrected this problem internally because user modifications may not be supported by the vendors. Because of the importance of this modification, IMB should continue to encourage the software vendors involved to develop a suitable modification.

RECOMMENDATIONS:

2. *IMB should strengthen oversight of state agencies' duties involving data security and access controls by:*
 - *developing reporting procedures to identify agency personnel authorized to create logonIDs, grant access to data sets, and follow up ACF2 violations;*
 - *suspending unused logonIDs, requiring logonIDs to be used when created, and making agencies aware of the problem of unused logonIDs;*

- *developing procedures to identify employees with active logonIDs that have left state service or changed employment, and;*
- *devising a system to verify that agency output is given only to authorized personnel.*

3. *IMB should take any necessary steps to establish access controls over UCC7.*

IMB has no formal disaster recovery plan.

The State of Minnesota relies on its central computer for many critical systems such as the statewide accounting system, income tax processing, and the criminal justice system. A formal, written disaster recovery plan is needed to ensure a rapid recovery of these systems from either short interruptions or a catastrophe.

A recovery manual should be prepared to identify:

- loss exposures, the risks the installation is exposed to;
- critical and vital applications;
- resources necessary to operate critical and vital operations;
- responsibilities of each organizational unit in case of a disaster;
- location where operations can continue and the extent of backup equipment; and
- security controls needed during recovery. Protection of critical assets if normal security measures break down.

The absence of a written disaster recovery plan could result in critical risk exposures or unrecoverable aspects of major systems. The state could lose major functions for an excessive amount of time or lose data permanently. Recovery costs could be minimized with a formal plan addressing planned approach to recovery of both systems and data.

IMB has addressed some aspects of disaster recovery and it has many backup features for continuing operations including a backup power supply and identification of personnel for recovery procedures. However, there has not been a formal risk analysis, analysis of recoverability of critical systems, or written procedures for recovery.

RECOMMENDATION:

4. *IMB should develop a formal written plan for disaster recovery and interruption of operations.*

Information Management Bureau (IMB) disbursements are not always supported by signed receiving reports and are often coded with inaccurate occurrence dates.

Receiving reports are not always being prepared at IMB to verify receipt of goods or equipment before payments are made. A new policy was established during fiscal year 1986 requiring IMB staff to complete a receiving form for all equipment and supply purchases. However, numerous supply and equipment disbursements remain unsupported by signed and dated receiving reports. Rather than completing receiving reports, managers within the division review the invoice for payment approval when it arrives and date it with a current date.

Several procedural problems occur at IMB because of this process. First, the invoice may not be received until several weeks after the goods were delivered. By that time, it may be difficult for the approver to remember the exact quantity received, especially for routine items. Also, since the approval date rather than the delivery date is shown on the invoice, it is difficult to determine which invoices represent liabilities for financial reporting purposes at June 30. Finally, because all invoices must be distributed for approval before they are paid, the entire payment process is delayed.

Receiving reports are an important control to ensure that IMB is only paying for goods actually received and to determine the accurate occurrence date. The occurrence date should indicate the date that IMB incurred the liability for paying the vendor. The occurrence date is generally the date the goods or services were received. The use of receiving reports and accurate occurrence dates is required by the Department of Finance Operating Policy and Procedure 06:05:01.

RECOMMENDATION:

5. *IMB should complete signed and dated receiving reports for all supply and equipment purchases. The completed receiving report should be compared to the approved vendor invoices before payment is made. The receiving report date should be used as the occurrence date.*

IMB subsidiary accounts receivable records are not reconciled to the IMB general ledger control account.

The IMB accounts receivable records consist of the monthly billing printout for each agency. Payments are posted onto the billing printout when the transfer occurs. Outstanding accounts receivables includes all printouts for which no payments, or partial payments, have been posted. An analysis of the accounts receivable report is produced monthly to provide a system for pursuing old unpaid bills and to serve as the subsidiary record. A general ledger control account contains billing and payment activity for all subsidiary accounts and is used for financial reporting.

There is no control established to ensure that the posting to subsidiary accounts receivable records is complete and accurate. Without such a control there is no assurance that the subsidiary accounts accurately support the year-end financial statements. Such control could be established by reconciling the June 30 subsidiary accounts receivable balances to the general ledger control account and ultimately to the financial statement balance.

RECOMMENDATION:

6. *The IMB accountant should reconcile the June 30 list of subsidiary accounts receivable balances to the general ledger and to the financial statements.*

TELECOMMUNICATIONS

The Telecommunications Division is responsible for the planning, design, acquisition, and approval of telecommunications services for all state agencies.

Telecommunications billing procedures and records need to be improved.

The Telecommunications revolving fund was established to centrally control and bill telephone usage for the state. Until October 1986, the telephone companies provided Telecommunications with computer tapes of calls, based on originating telephone number. Telecommunications processed the tapes and produces a computer report by account showing which agencies to bill. This report was revised as necessary by the Telecommunications accountant and sent to the Administration Fiscal Services Division, where the monthly invoices were prepared manually. According to Telecommunications procedures, Telecommunications was to send the report to Fiscal Services "by the 20th of the month following the period covered. Fiscal Services will process and mail the invoices within two weeks after receipt."

Once the user agency receives their Telecommunications bill, they are required by Finance Operating Policy and Procedure 06:09:06 to pay within five working days. According to this policy, if an agency disputes a bill, they should still pay the full amount and then request a credit.

Telecommunications is experiencing long delays in both billing and receiving payments. As of June 30, 1986, the May bills had not been sent out. In fact, the June bills were not sent out until after August 11, 1986. However, it is difficult to determine the exact cause of these delays. Neither preparation nor mailing dates are included on billing summaries or the Telecommunications invoices. Because of these billing delays, the subsidiary accounts receivable records are not posted on a timely basis. Without timely posting and a clean cutoff between fiscal years, accurate accounts receivable balances are difficult to determine.

In addition, several agencies appear to be delinquent in paying their Telecommunications invoices. Since the invoices are not dated, it is difficult to determine which agencies have not complied with the Finance policy.

Telecommunications will be able to shorten their processing time by computerizing more of their billing procedures. During fiscal year 1986, the Fiscal Services accountant manually prepared the Telecommunications invoices from information on the computer report by account. Expanding computer processing to include directly generating invoices will decrease one portion of their billing delays.

Billing delays could also be decreased through changes in the way Telecommunications handles billing adjustments. Telecommunications identifies telephone numbers assigned to each user agency as the basis for agency charges. If a telephone number is not identified, any charges from that number become "unidentified calls." Telecommunications personnel are responsible for identifying the billable agency for these calls. Once identified, billing adjustments are made to previous months' invoices. Each adjustment bill is given the same invoice number as the original bill. Telecommunications currently does not have a time or dollar limit on the unidentified calls that they will pursue. Therefore, adjustments may not be billed until three to six months after the date of service. This causes a great deal of confusion for the user agencies. They often do not understand what the adjustment is for and may be more likely to withhold payment or dispute the bill. The adjustments are not given a separate, sequential number. This causes a weakness in control, because there is no systematic way to verify that all adjustment bills were sent and recorded. Telecommunications should determine a time and amount limit in pursuing these calls. Unbilled calls should be absorbed as part of Telecommunications overhead costs.

In addition, responsibility for pursuing uncollected accounts receivable is not effectively designated. Presently, a Fiscal Services accountant is responsible for preparing and distributing follow-up letters. However, these letters have not been timely. The accounts receivable aging schedule prepared on August 31, 1986, reflected \$9,457 in accounts receivable between 60 and 90 days old and \$27,279 over 90 days old. Many of the uncollected accounts receivable are the result of disputed bills. Because of the technicalities of these disputes, the Fiscal Services accountant cannot effectively respond to these claims. Therefore, the Telecommunications financial services unit should be responsible for pursuing their uncollected accounts from the aging schedule provided by Fiscal Services.

RECOMMENDATIONS:

7. *Telecommunications should continue their effort to computerize their billing process in order to decrease processing time.*
8. *Telecommunications should improve their billing process by:*
 - *ensuring that bills are sent out timely,*
 - *establishing a policy on length of time and minimum amount to pursue and adjust prior billings for "unidentified calls,"*

- monitoring agency collections to determine compliance with the five day Finance requirement,
- revising its invoice form to include a mailing date, and
- sending all adjustments to monthly bills on separate, sequentially numbered invoices. Each adjustment should include a complete description of what the additional charges include.

9. Telecommunications financial services unit should designate a staff person responsible for pursuing technical issues relating to uncollected accounts receivable.
10. The subsidiary accounts receivable records should provide a clean cutoff between fiscal years. The posting to the subsidiary accounts receivable records should be done on a timely basis. The subsidiary accounts receivable records should be used for the Telecommunications financial statements.

Telecommunications is inappropriately accounting for billing credits.

There are several problems with the way Telecommunications handles and documents billing credits. Telecommunications gives credits to user agencies for amounts incorrectly billed. In some cases, these amounts are ultimately billed to another agency. In other cases, the correct agency is never identified. For several years, credits which could not be identified to another agency have been funded out of the Telecommunications General Fund account. These transfers were made, rather than reducing Telecommunications revolving fund revenues. There is no authorization for Telecommunications General Fund appropriations to be used for this purpose. During fiscal year 1986, credits totalling \$17,173 were charged to the General Fund inappropriately.

Another problem with the credit process relates to credit documentation. Telecommunications credit memos are not sequentially numbered or controlled. The use of prenumbered documents would prevent both the failure to record the credit and the possibility of duplicate credits. It would also lessen the chance of manipulation of credits.

A final problem with the Telecommunications credit process is that they have no specific policy on who can issue credits and when credits should be given. In two cases, credits totalling \$3,747 were given by a staff person who normally does not issue credits. Although these credits were valid, they were not properly documented and were never communicated to the accounts receivable accountant.

RECOMMENDATIONS:

11. Telecommunications should discontinue the practice of funding billing credits from their General Fund account. Inappropriate payments made from the General Fund should be returned.

12. *Telecommunications should establish a credit policy designating authorized staff and procedures to be followed.*
13. *Credit memos should be sequentially numbered and controlled.*

CENTRAL MOTOR POOL

The Central Motor Pool (CMP) Division maintains a fleet of motor vehicles which are rented to state agencies on a daily, weekly, or monthly basis.

Motor Pool has initiated prepayment on new vehicle acquisitions through the Master Lease Fund.

Central Motor Pool began acquiring new vehicles in fiscal year 1986 through payments from the Master Lease Fund. This fund was created by the Laws of 1985, 1st Special Session, Chapter 13, Section 116. The Master Lease Fund was established to economically purchase equipment for state agencies and to enable agencies to gain favorable interest rates.

Finance Operating Policy and Procedure 06:09:13 outlines the purchase and payment process through the Master Lease Fund. After a bid is awarded, Administration's Procurement Division issues a purchase order to the successful vendor. Later, the agency receives the equipment and invoice from the vendor. The agency should verify that the equipment is operational and the invoice is correct. According to the policy and procedure, the agency is then required to complete and sign an acceptance certificate and submit it with the original invoice to the Department of Finance. This should occur within 15 days of receiving the equipment or invoice, whichever is later. Finance then initiates a payment to the vendor through the Master Lease Fund.

One of the purchase orders issued by the Materials Management purchasing unit for Motor Pool during fiscal year 1986 was for 145 vehicles at a cost of \$1,067,635. In order to ensure equal spacing of vehicle deliveries, Motor Pool entered into a separate agreement with the successful car dealership. This agreement required immediate payment of the dealer's invoices, whether or not the vehicles had been delivered. To obtain payments through the Master Lease Fund for these cars, Motor Pool staff signed and submitted acceptance certificates and vendor's invoices to the Department of Finance for payment one to two months before the cars were delivered. These acceptance certificates falsely acknowledged vehicle delivery and indicated that Motor Pool had accepted responsibility for the vehicles, when in fact delivery had not yet occurred. Once the dealer was paid, a certificate of title was issued to the State of Minnesota for each vehicle involved. As of June 30, 1986, nine of the vehicles paid for in March 1986 still had not been delivered. These cars were valued at \$66,267 and had been capitalized as fiscal year 1986 fixed assets. They were delivered to Motor Pool in July 1986.

Initiating payment of the dealer's invoice through the Master Lease Fund before the vehicles were delivered did not comply with Finance Operating Policy and Procedure 06:09:13. In addition, the Motor Pool agreement with the dealer and the subsequent payments prior to delivery violates Minn. Stat. Section 16A.15, Subd. 3, which prohibits payment without a prior

obligation. Since the vehicles had not been received nor any benefit obtained, no obligation existed to pay the vendor. Also, since the Master Lease Fund invests cash until needed, Master Lease interest income was reduced as a result of the early payments. Finally, Motor Pool incurred additional interest expense since they were required to begin repayment of their Master Lease loan sooner than necessary.

RECOMMENDATIONS:

14. *Central Motor Pool should not sign acceptance certificates until the vehicles have been received and inspected by agency personnel.*
15. *Motor Pool should not allow payments to be made to vendors before the obligation has been incurred.*

PLANT MANAGEMENT

The Plant Management Division is responsible for the maintenance, operation, and upkeep of state-owned buildings and offices.

Plant Management fixed asset records and control procedures need improvement.

The Plant Management Division owns fixed assets with a historical cost of \$1,140,702. These assets are located in various buildings throughout the capitol complex. Overall management and accountability for fixed assets is assigned to the division's inventory coordinator. The inventory coordinator is responsible for monitoring and recording fixed asset additions, retirements, and transfers. The inventory coordinator is assisted by certain people in each building who are delegated responsibility for custody of fixed assets located in their specific areas.

There are several weaknesses in the recording and control of Plant Management's fixed assets. First, Plant Management is currently operating without a detailed fixed asset system. The inventory coordinator's most current list of the division's fixed assets was dated May 1984, shortly before the state's old fixed asset system was discontinued. All additions, deletions, and transfers made since that time are recorded on individual adjustment forms. The inventory coordinator cannot effectively control fixed assets from an outdated list which excludes all changes for a period over two years. Also, without a current, comprehensive list, it is difficult for the inventory supervisor to coordinate with the building personnel responsible for the fixed assets under their responsibility. Plant Management fixed asset data is not included on the state's Fixed Asset Records Management System (FARMS).

For the fiscal year 1986 Plant Management financial statements, the Administration Fiscal Services Division obtained and organized the outdated fixed asset list and adjustment forms. They generated a record detailing fixed asset original costs, depreciation expense, and accumulated depreciation. This list was adequate to support the fixed asset values shown on the financial statements. However, tracing individual items from this list to verify physical existence was tedious. This Fiscal Services list

does not provide sufficient location information to allow it to be useful to the inventory coordinator in physically controlling and accounting for the individual fixed assets.

Another weakness in controlling Plant Management's fixed assets relates to verifications of physical existence. Plant Management has an internal policy which requires that all asset locations be spot-checked on an annual basis. It also requires that a composite report of the results of the physical spot-checks be submitted to the division's director. However, the inventory coordinator has not adhered to this policy. Several asset locations have not been spot-checked for over two years. The last inventory composite report submitted to the division director was dated April 27, 1984. In addition, physical spot-checks that were performed were not effective since unlocated items or additional items identified were not properly resolved.

Overall accountability and control of Plant Management's fixed assets could be greatly improved if a detailed fixed asset record or system was used. Such a system would allow current addition, deletion, and transfer information to be generated and distributed to each building supervisor for effective physical control purposes. It would provide the basis for physical inventory spot-checks and could also be used for financial reporting purposes.

RECOMMENDATIONS:

16. *Plant Management should enter all fixed assets onto a fixed asset record which can be used by the inventory coordinator for accountability and control purposes and can also be used by Fiscal Services in the preparation of financial statements.*
17. *All fixed asset inventory locations should be spot-checked annually as required by Plant Management internal policy, with a composite report submitted to the Plant Management director.*

Plant Management perpetual inventory pricing records require improvement.

Plant Management maintains an extensive consumable inventory of parts and supplies. The inventory is priced using the "moving weighted average cost method." Using this method, a new average unit cost is calculated after each new purchase. The calculated unit cost becomes a part of the operating costs of the building in which the item was used and ultimately impacts the building's rental rate. Two major problems exist with the inventory pricing records. First, in some cases, the trail for reviewing unit cost calculations does not exist. Second, some inventory cards contain pricing errors.

When additional items of inventory are purchased, the inventory clerk determines the new average unit cost for the item by using both the new purchase price and the previous average unit price. He then erases the previous unit cost on the inventory card. Erasing this old average unit cost amount destroys the trail for recalculating both current and prior prices. In some cases, the price can be reconstructed by reviewing a series of purchase orders. In other cases, the unit cost cannot be readily confirmed.

In addition, some inventory prices were calculated erroneously. Eighteen percent of the inventory prices examined were found to have errors in the determination of the average cost per unit. These errors resulted from using the last unit purchase price as the average cost or by posting the incorrect actual cost amount to the perpetual records. In some cases, contract prices or purchase discounts were not reflected in the price used to compute the average unit cost.

Accurate inventory valuation using consistent inventory pricing methods is required by generally accepted accounting principles (GAAP) and are important to ensure proper costs are charged to the buildings when inventory items are used. An adequate trail to support the pricing of inventory items, and clerically accurate records are necessary to ensure that all Plant Management inventory is priced correctly.

RECOMMENDATIONS:

18. *Plant Management perpetual inventory records should be revised to retain previous moving weighted average unit prices on the inventory card.*
19. *The Plant Management inventory supervisor should periodically review the accuracy of moving weighted average price calculations.*

Plant Management is not requiring agencies to promptly pay rents.

The Real Estate Management Division is responsible for the coordination and approval of each departmental lease identifying annual and monthly rent amounts due. Effective July 1, 1985, Plant Management is responsible for collecting rent from tenants in all state-owned buildings, including those in the capitol complex, the Capitol Square building, the health building, and the Duluth Government Center. Fiscal year 1986 rent revenue for Plant Management totalled \$12,081,876.

Rent collections are governed by Minn. Stat. Section 16B.24, Subd. 5(e) and by the Department of Finance. Finance Operating Policy and Procedure 06:09:07 requires agencies to make twelve equal monthly rent payments to Plant Management by each month-end. This contrasts with the old quarterly payment schedule previously required. The Finance procedure also establishes a mechanism for enforcement by requiring Administration to monitor payment promptness and report delinquent agencies to the Department of Finance. Agencies that are delinquent in paying their rent may have their interagency payment authority revoked, and future interagency payments would be made by Finance.

Several agencies are not paying rent monthly as required. Fifty-three agencies (58 percent) of 91 agency leases tested did not pay rent monthly during fiscal year 1986. Most of these agencies were still making quarterly rent payments, as had been previously required. However, one agency had not made any payments on its annual rent of \$350,000. In addition, the Information Management Bureau of Administration, which was experiencing cash flow problems during fiscal year 1986, was allowed to defer

payments of \$200,056, or half the annual rent due. As of December 1, 1986, this amount had still not been paid. Several other agencies paid their rent irregularly during the year. None of these delinquencies were reported to the Department of Finance during fiscal year 1986. Prompt monthly rent payments are necessary to avoid future cash flow problems for Plant Management and to comply with Finance policies.

RECOMMENDATION:

20. *Plant Management should remind all agencies that rent payments are due monthly. They should monitor the promptness of rent payments and refer delinquencies to the Department of Finance.*

STATE PRINTER

The printing and duplicating section of the Printing and Mailing Services Division processes all printing and duplicating requests from state agencies. This section is commonly referred to as the State Printer.

Quality improvement expenses paid from the State Printer revolving fund were not properly approved.

In fiscal year 1984, a quality improvement program was started for State Printer employees to encourage them to improve the quality and timeliness of the jobs printed. This program provides for employee involvement and awareness through a committee which informs other employees of measured results and improvements. Recognition for quality achievement is another key aspect of the program. This recognition includes "Employee of the Month" awards and an annual luncheon for "Employee of the Year." The goal of this program is to increase efficiency, quality, and timeliness of printing jobs.

Certain costs of the quality improvement program produce special benefits to Printer employees which are not generally available to other state employees. These costs are therefore ineligible according to state rules, unless special expense authorization is obtained. Special expense guidelines have been promulgated by the Department of Employee Relations (Administrative Procedure 4.4). Procedure 4.4 provides that "special expenses are expenses incurred in connection with assigned official duties of a state employee which are not reimbursable through regular expense regulations." Meal expenses (when they are a part of a structured agenda of a conference, workshop, seminar, or meeting which the appointing authority has authorized) are allowable special expenses. Procedure 4.4 requires that the Department of Employee Relations approve special expenses before costs or commitments are incurred. Administration has filed a plan which indicates their general intentions and procedures for special expense.

Total Printer expenses as part of the quality improvement program were \$1,769 for fiscal year 1986. The primary cost of \$678 was incurred for the annual luncheon for all State Printer employees. The annual luncheon was approved through the special expense process. However, the necessary approvals were not obtained until after the luncheon had been held and costs had been incurred. Additional purchases of \$509 were made to obtain

employee recognition plaques and \$472 was spent to acquire jerseys (not uniforms) for Printer employees. These additional costs were not submitted to Employee Relations as special expenses. In addition, they do not qualify under the criteria set forth in the departmental special expense annual plan.

Over \$4,000 was expensed during fiscal years 1984 and 1985 for the quality improvement program, and \$900 has been paid thus far in fiscal year 1987. The additional personal benefits paid to Printer employees under the quality improvement program are ineligible under state rules without special expense authorization.

RECOMMENDATION:

21. *The State Printer quality improvement program spending must comply with the special expense provision of the Department of Employee Relations. Costs which do not meet the special expense criteria should not be incurred.*

PRIOR RECOMMENDATION NOT IMPLEMENTED: The State Printer does not have an adequate accounts receivable system for monitoring outstanding balances and determining accounts receivable for financial reporting.

During fiscal year 1986, primary control over payment of State Printer charges was transferred from Administration to the user agencies. This change has placed Adminstration in a role similar to that of an outside vendor. The State Printer submits invoices to user agencies. These agencies then make transfers in the Statewide Accounting (SWA) System from their account to the State Printer's account. This change in control has created a need for improved accounts receivable records and procedures at the State Printer.

Currently, the State Printer manually posts invoice amounts to a sales journal before the invoices are sent out. Payments are then posted to the sales journal from reports of account transfers in SWA. Those invoices for which no payments have been posted in the sales journal are considered to be outstanding accounts receivable. However, the State Printer is not always certain that all SWA transfers have been posted in the sales journal. Transfer information coded on SWA is often incomplete and difficult to match against the original invoice. In addition, user agencies may make several partial payment transfers relating to a single invoice, therefore compounding the matching problem. Finally, calculating accounts receivable totals becomes clerically tedious because someone must total all blank lines in the sales journal in order to calculate outstanding accounts receivable.

To maintain effective control over accounts receivable, to ensure that all amounts billed are collected, and to ensure the accuracy of the financial statement figures for accounts receivable, an adequate accounts receivable system must be developed. In addition, subsidiary accounts receivable records should be periodically reconciled to the general ledger control account to provide assurance that all transactions were posted correctly.

During fiscal year 1987, the State Printer began developing a computerized accounts receivable system. However, the system is only in the initial phase and is not yet operational.

RECOMMENDATION:

22. *The State Printer should develop a subsidiary accounts receivable system to monitor outstanding balances and which can be used for financial reporting.*

MATERIALS MANAGEMENT

The purchasing unit of the Materials Management Division coordinates the purchase of all supplies and equipment for state agencies.

PRIOR RECOMMENDATION NOT IMPLEMENTED: Unsecured checks are being accepted by the purchasing unit as security for contract performance.

Bid security is required by the purchasing unit in order to guarantee that, in the event the bidder's offer is accepted by the state, the bidder will enter into a contract in accordance with the bid proposal. This security may take the form of a bid bond or a check. Checks of unsuccessful bidders are returned to the vendors after the bid has been awarded. Checks of successful vendors are held as supply security until the contract is satisfactorily completed. This may be a year or longer, especially for ongoing commodity contracts.

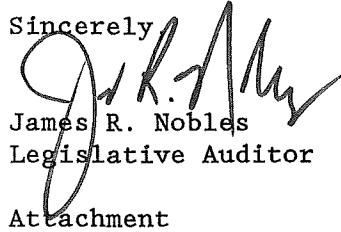
We counted all checks being held by the purchasing unit for bid or supply security as of July 25, 1986. We found that checks totalling \$247,463 were on hand as of that date. Most of these checks were secured checks, such as cashier's or certified checks. However, 13 of the checks totaling \$7,975 were regular business or personal checks. It is therefore possible that, even though the successful vendor may violate the contract, the purchasing unit may be unable to collect on these personal checks. This same concern was raised in prior management letter reports, however unsecured checks continue to be accepted by the purchasing unit. According to Procurement Bulletin 7-206, only certified checks or bid bonds are to be accepted. Therefore, these unsecured checks should not have been accepted as bid or supply security.

RECOMMENDATION:

23. *The purchasing unit of the Materials Management Division should accept only certified checks or bid bonds as bid and supply security.*

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

Sincerely


James R. Nobles

Legislative Auditor

Attachment

February 12, 1987


John Asmussen, CPA
Deputy Legislative Auditor

DEPARTMENT OF ADMINISTRATION

STATUS OF PRIOR AUDIT RECOMMENDATIONS
AND
PROGRESS TOWARD IMPLEMENTATION

Administration Management Letter dated February 18, 1986

Some Administration revolving funds do not have adequate accounts receivable systems for monitoring outstanding balances and determining accounts receivable for financial reporting.

1. Administration should develop adequate accounts receivable systems for all Administration revolving funds, to be used to monitor outstanding balances and as a source of the financial statement figures for accounts receivable.

RECOMMENDATION NOT IMPLEMENTED. See current recommendations #6, #10, and #22.

Accounting for and documentation of Administration's performance incentive program (PIP) need to be improved.

2. Administration should maintain adequate records and documentation for PIP. All PIP plan approvals, including revisions, should be documented in writing. PIP disbursement records should include the amount, transaction number, vendor, and PIP category for each disbursement.

RECOMMENDATION WITHDRAWN. Due to budget constraints, the PIP program was suspended for fiscal year 1986. These recommendations will be reviewed if and when the program resumes.

3. Administration officials should consider using year-ended June 30 financial statements for determining PIP profits. However, if the March 31 statements continue to be used:

- steps should be taken to ensure the integrity of the March 31 information; and
- fiscal services should develop a procedure for consistently determining the year to date March 31 financial statement figures.

RECOMMENDATION WITHDRAWN. Due to budget constraints, the PIP program was suspended for fiscal year 1986. These recommendations will be reviewed if and when the program resumes.

Two Administration revolving funds do not have adequate general ledger accounting systems.

4. Administration should ensure that detailed general ledgers and general journals are established and maintained for Telecommunications and Central Stores. Postings to these records should be done at least monthly.

RECOMMENDATION IMPLEMENTED. General ledgers and journals were established and maintained by the appropriate Administration accountant during fiscal year 1986 for these internal service funds.

The accuracy of financial information reported for IMB's fixed assets needs improvement.

5. IMB's fixed asset general ledger control accounts should be periodically reconciled to the subsidiary fixed asset subsidiary records.

RECOMMENDATION IMPLEMENTED. The fixed asset control account was reconciled to the subsidiary records as of June 30, 1986.

Procedures for compiling the State Printer's work-in-process inventory need improvement.

6. The State Printer should ensure the accuracy of their year-end work-in-process inventory by performing timely and adequate reviews of each printing job to determine that all costs have been included and that the job is properly classified on the financial statements.

RECOMMENDATION IMPLEMENTED. The State Printer properly identified their June 30, 1986 work-in-process costs.

Reorder points have not been developed and used for the State Printer's raw materials inventory.

7. The State Printer should establish reorder points for all raw materials inventory items and enter them into their computerized job cost system.

RECOMMENDATION IMPLEMENTED. During fiscal year 1986, reorder points were established and entered into the State Printer's computerized inventory system.

CMP needs to improve their inventory records.

8. CMP should review inventory records to ensure that they are accurate, reconcile to the physical inventory counts, and all valuations are in accordance with GAAP.

RECOMMENDATION IMPLEMENTED. On February 17, 1986, CMP's new computerized inventory system was begun. This system consistently determines GAAP valuations and is reconciled to physical inventory counts.

9. CMP should develop and implement a system to detect and properly dispose of obsolete inventory.

RECOMMENDATION IMPLEMENTED. The new CMP automated inventory system determines inventory turnover rates and identifies slow-moving or obsolete items.

Transactions involving vehicles leased by CMP were not properly recorded.

10. The fiscal services accountant for CMP should work with the CMP division staff to make sure that all newly acquired fixed assets are included on the financial statements as of the proper date, and that these assets are capitalized at the proper amounts.

RECOMMENDATION IMPLEMENTED. Fiscal year 1986 fixed asset acquisitions were properly capitalized and included on the CMP financial statements.

Checks held by Procurement for contract performance security need better management.

11. Procurement should accept only certified checks or bid bonds as bid and supply security.

RECOMMENDATION NOT IMPLEMENTED. See current recommendation #23.

12. Procurement should deposit all checks held as supply security from successful bidders into the state treasury.

RECOMMENDATION WITHDRAWN. In a letter written to the Procurement Division, the Special Assistant Attorney General for Administration concluded that it would not be cost beneficial to deposit security checks from successful bidders. Procurement has improved controls over safekeeping of these checks to minimize the risk of loss or theft.

DEPARTMENT OF ADMINISTRATION

STATUS OF PRIOR AUDIT RECOMMENDATIONS
AND
PROGRESS TOWARD IMPLEMENTATION

Review of General EDP Controls dated March 11, 1986

The IMB Security Group should be located independently from other organizational areas and they should have an independent review of their work.

1. The Data Security Group should be in an organizational area separate from a software development area. The Data Security Group should be at a level high enough in the organization to maintain independence in dealing with granting access and other security issues.

RECOMMENDATION IMPLEMENTED. The Security Group has been moved to a higher level in an area separate from software development.

2. A regular independent review of access rule changes and violation attempt followups should be performed by someone outside of the IMB Security Group.

RECOMMENDATION WITHDRAWN. The new supervisor of the Security Group is now in the position to establish reporting and review procedures. We will review the procedures he has established during our next audit.

User agencies sometimes fail to provide the IMB Security Group with sufficient documentation.

3. The IMB Security Group should obtain written documentation to support all modifications to logonIDs and rules, including those granted through verbal authorizations.

RECOMMENDATION IMPLEMENTED. Documentation is substantially improved. There is a log of changes and major changes have supporting documentation.

4. The IMB Data Security Group should strengthen procedures for identifying employees with active logonIDs that have left or changed employment.

RECOMMENDATION NOT IMPLEMENTED. See current recommendation #2.

The UCC7 job scheduling package operates outside of the ACF2 security system.

5. The Information Management Bureau should evaluate software modifications that enable ACF2 to provide access control protection for the UCC7 package. If it is not feasible to implement a software modification, alternative access controls should be implemented.

RECOMMENDATION NOT IMPLEMENTED. See current recommendation #3.

The control over system output needs improvement.

6. There should be an improved system for giving output to authorized people.

RECOMMENDATION PARTIALLY IMPLEMENTED. IMB has installed an output window and made other improvements over output. However, identification of those receiving output is still not required. See current recommendation #2.

DEPARTMENT of Administration

STATE OF MINNESOTA

Office Memorandum

TO: Jeanine Leifeld, Audit Manager
Office of the Legislative Auditor

DATE: February 12, 1987

FROM: Sandra J. Hale *Sandra Hale*
Commissioner

PHONE: 296-6940

SUBJECT: Management Letter

I appreciate the opportunity to review and comment on the preliminary draft of your management letter regarding this department as a result of your financial audit of the State of Minnesota's fiscal year 1986 financial statements. The assistance given to this department by the audit staff will be helpful as we continue our efforts to improve our financial management practices.

We have numbered our responses to correspond to your recommendations. Our responses outline what we have done or propose to do to implement your recommendations.

RECOMMENDATION 1

The Department of Administration will work with the Department of Finance in a more formal fashion to determine when a general fund loan should be obtained or if obligations between funds can be deferred to mitigate cash flow problems. Agreements with the Department of Finance for payment deferrals will be in writing. This will be completed by June 30, 1987. Assistant Commissioners will be responsible for implementing this recommendation in their areas.

RECOMMENDATION 2

IMB will work with the Information Policy Council (IPC) and the Systems Advisory Council (SAC) to develop a process to formally identify agency contacts for the control of system and data access. This will be completed by June 1, 1987. Howard Tri is responsible for this recommendation.

IMB will work with the IPC and the SAC to develop procedures to control unused logon ID's. This will be completed by June 1, 1987. Howard Tri is responsible for this recommendation.

IMB will work with the Department of Finance to identify staff terminations, transfers, and leaves of absence so that additional controls can be exercised over logon ID's. This will be completed by the end of F.Y. 1987. Howard Tri is responsible for this recommendation.

IMB will work with the IPC and the SAC to develop control procedures for distribution of reports and tapes through the IMB output window. This will be completed by June 30, 1987. Doug Schneider is responsible for this recommendation.

RECOMMENDATION 3

IMB will work with applicable software vendors to ensure the development of appropriate interfaces between ACF2 and UCC7. Based on information received from the vendors, we estimate that this interface can be installed by March 1, 1988. Dick Kelly is responsible for this recommendation.

RECOMMENDATION 4

IMB has requested general fund support for the F.Y. 1988-89 biennium for the development of a formal plan for disaster recovery. Without provision of general fund support a disaster recovery plan cannot be developed. If funding is approved, work will begin on this effort in July, 1987.

RECOMMENDATION 5

IMB established a policy in F.Y. 1986 requiring IMB staff to complete receiving forms for all equipment and supply purchases. Further work will be done during F.Y. 1987 to ensure more uniform compliance with this policy. Phil Allison is responsible for this recommendation.

RECOMMENDATION 6

IMB subsidiary accounts receivable were reconciled to the general ledger for the December 31, 1986 financial statements. This will be done periodically but at least each June 30th. Ralph Fredlund, Fiscal Services is the person responsible.

RECOMMENDATION 7

Billing for telephone usage has been computerized and billing for equipment and line usage is in the testing stage of computerization and will be operational by the end of F.Y. 1987. Phil Allison is responsible for this recommendation.

RECOMMENDATION 8

Computerization of billings has already resulted in some improvement in the timeliness of bills. It is our objective to obtain timely billings by the end of F.Y. 1987.

A procedure establishing length of time and minimum amount for pursuing and adjusting prior billings for "unidentified calls" will be developed and implemented by March 1, 1987.

Accounts Receivable collection responsibility is being assumed by the telecommunications financial services unit within Resources Management. Fiscal

Services provides this unit with monthly accounts receivable reports, and a form letter (recently designed and printed) will be sent to past due accounts.

A modification will be made to the billing system(s) as necessary to provide invoice dates.

A "billing adjustment" form will be developed and implemented for use by the telecommunications financial services unit by March 1, 1987. It will provide for unique invoice numbers and descriptions of adjustments. Phil Allison is responsible for this entire recommendation.

RECOMMENDATION 9

The telecommunications financial services unit will pursue uncollected accounts receivable. This procedure will be effective immediately. Phil Allison is responsible for this recommendation.

RECOMMENDATION 10

Improvements will be made on obtaining a clean June 30th cut off on Telecommunications subsidiary accounts receivable ledger and posting will be performed on a more timely basis. Financial statements will use the subsidiary ledger balance or be reconciled to it. This should be implemented by June 30, 1987. Ralph Fredlund, Ginn Young and Guntis Schefers will be the persons responsible.

RECOMMENDATION 11

The practice of funding some credit requests from the General Fund was unintentional and has been discontinued. The \$17,173 inappropriately used in F.Y. 1986 will be returned to the General Fund. Phil Allison is responsible for this recommendation.

RECOMMENDATION 12

A policy for providing credits will be established and implemented by March 1, 1987. This policy will be similar to that in use for the Computer Service Revolving Fund. Phil Allison is responsible for this recommendation.

RECOMMENDATION 13

The credit policy described in Recommendation 12 will include the use of a sequentially numbered and controlled form. Phil Allison is responsible for this recommendation.

RECOMMENDATION 14

Central Motor Pool will not sign acceptance certificates until the vehicles have been received and inspected by agency personnel. Karen Carpenter is the person responsible.

RECOMMENDATION 15

Motor Pool will not allow payments to be made to vendors before the obligation has been incurred. Karen Carpenter is the person responsible.

RECOMMENDATION 16

Plant Management began utilizing the FARM system when it was implemented in July of 1985. In order that our financial statements could be prepared, Fiscal Services developed a program to be utilized on a short term basis so that our financial reporting requirements could be met. This is currently being done on an IBM PC located in the Fiscal Services Division. When the FARM system is able to meet our Plant Management needs, we will utilize the system for both the accountability of assets and for financial reporting purposes.

RECOMMENDATION 17

All fixed asset inventory locations will be spot checked annually with a composite report submitted to the Plant Management Director. Implementation will be by June 30, 1987. Joe Koerner will be the person responsible.

RECOMMENDATION 18

Effective July 1, 1986 the Inventory Control Supervisor began leaving the previous moving weighted average unit price in the inventory cards. Robert Graf is the person responsible.

RECOMMENDATION 19

The Inventory Control Supervisor will begin to review the accuracy of the weighted averages by reviewing purchase orders and other necessary documentation to support the pricing. The supervisor plans to review approximately ten percent of the items each year. Robert Graf is the person responsible.

RECOMMENDATION 20

Notices will be sent to accounting coordinators reminding them that rent payments are due monthly. March 1, 1987 is the implementation date. James Ware is the person responsible.

RECOMMENDATION 21

Future quality improvement spending will comply with the special expense provision of the Department of Employee Relations. Costs which do not meet the special expense criteria will not be included. Implementation will be by March 1, 1987. Berry Conway will be the person responsible.

RECOMMENDATION 22

An accounts receivable program has been developed to monitor outstanding balances which can be used for financial reporting. This process began at the beginning of Fiscal Year 1987 and will be in effect for this and future fiscal years. The person responsible for implementation is Tom Vesely.

RECOMMENDATION 23

Unsecured checks will not be accepted by the purchasing unit of Materials Management. Only certified checks, bid bonds or cashiers checks will be accepted. Implementation date is February 3, 1987. The person responsible is Don Olson.