

**DEPARTMENT OF TRADE AND  
ECONOMIC DEVELOPMENT  
GOVERNOR'S RURAL DEVELOPMENT COUNCIL  
FINANCIAL AND COMPLIANCE AUDIT  
FOR THE YEAR ENDED JUNE 30, 1987**

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**DECEMBER 1987**

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**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

Representative Phillip J. Riveness, Chairman  
Legislative Audit Commission,

Members of the Legislative Audit Commission,

and

David Speer, Commissioner  
Department of Trade and Economic Development

**Audit Scope**

We have completed a financial and compliance audit of the Governor's Rural Development Council for the year ended June 30, 1987. Note 1 on page 4 provides a brief description of Council 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 October 30, 1987.

The objectives of the audit were to:

- express an opinion on the financial statements of the Rural Rehabilitation Trust Fund for the year ended June 30, 1987;
- study and evaluate agency internal control systems, including revenue, administrative expenditures, grant expenditures, assets, and liabilities;
- verify that financial transactions were made in accordance with applicable laws, regulations and policies, including Minn. Stat. Sections 116J.955 and 116J.961, and other finance-related laws and regulations; and
- verify that financial transactions were properly recorded on the statewide accounting system.

**Management Responsibilities**

The management of the Governor's Rural Development Council was responsible for establishing and maintaining a system of internal accounting control. In fulfilling this responsibility, estimates and judgements by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly.

Representative Phillip J. Riveness, Chairman  
Members of the Legislative Audit Commission,  
David Speer, Commissioner  
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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 Governor's Rural Development Council was also responsible for the agency's compliance with laws and regulations. In connection with our audit, we selected and tested transactions and records from the programs administered by the Governor's Rural Development Council. The purpose of our testing of transactions was to obtain reasonable assurance that the Rural Rehabilitation Trust Fund programs had, in all material respects, been administered in compliance with applicable laws and regulations.

#### Conclusions

We have issued an unqualified opinion on the Rural Rehabilitation Trust Fund's financial statements for the year ended June 30, 1987. Our opinion, dated October 30, 1987, is included in the financial section of this report.

In our opinion, except for the issues raised in Section II, findings 2 and 3, the system of internal accounting control of the Governor's Rural Development Council in effect on June 30, 1987, taken as a whole, was sufficient to provide management with reasonable, but not absolute assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization.

In our opinion, except for the issues raised in Section II, finding 1, for the year ended June 30, 1987, the Governor's Rural Development Council administered its programs in compliance, in all material respects, with applicable finance-related laws and regulations.

In our opinion, for the year ended June 30, 1987, the Rural Rehabilitation Trust Fund transactions were properly recorded, in all material respects, in the statewide accounting system.

The recommendations included in this audit report are presented to assist the Department of Trade and Economic Development in improving accounting procedures and controls over the Rural Rehabilitation Trust Fund. We will be monitoring and reviewing the department's progress on implementing these recommendations.

We would like to thank the Department of Trade and Economic Development staff for their cooperation during this audit.

  
James R. Nobles  
Legislative Auditor

December 9, 1987

  
John Asmussen, CPA  
Deputy Legislative Auditor

DEPARTMENT OF TRADE AND ECONOMIC DEVELOPMENT

GOVERNOR'S RURAL DEVELOPMENT COUNCIL

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AUDIT PARTICIPATION

The following members of the Office of the Legislative Auditor prepared this report:

John Asmussen, CPA	Deputy Legislative Auditor
Claudia Gudvangen, CPA	Audit Manager
Lori Pellicci, CPA	Auditor-in-Charge
Rhonda Warner	Staff Auditor

EXIT CONFERENCE

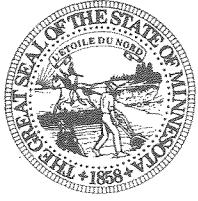
The findings and recommendations in this report were discussed with the following staff of the Department of Trade and Economic Development on December 9, 1987:

Jayne Khalifa	Senior Administrative Office
Robert Benner	Deputy Commissioner
Terry Pohlkamp	Director of Administrative Services



## **FINANCIAL SECTION**





STATE OF MINNESOTA

**OFFICE OF THE LEGISLATIVE AUDITOR**

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

JAMES R. NOBLES, LEGISLATIVE AUDITOR

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David Speer, Commissioner  
Department of Trade and Economic Development

We have examined the financial statements of the Rural Rehabilitation Trust Fund as of and for the year ended June 30, 1987. Our examination was made in accordance with generally accepted auditing standards, and accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of the Rural Rehabilitation Trust Fund at June 30, 1987, and the results of its operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

A handwritten signature of James R. Nobles.

James R. Nobles  
Legislative Auditor

A handwritten signature of John Asmussen.

John Asmussen, CPA  
Deputy Legislative Auditor

October 30, 1987

## DEPARTMENT OF TRADE AND ECONOMIC DEVELOPMENT

## GOVERNOR'S RURAL DEVELOPMENT COUNCIL

RURAL REHABILITATION TRUST FUND  
BALANCE SHEET  
June 30, 1987Assets

Cash	\$ 113,434
Investments	4,986,745
Notes and Loans Receivable	586,452
Accrued Income	87,018
Accounts Receivable	<u>32,130</u>
 Total Assets	<u>\$5,805,779</u>

Liabilities and Fund Balance

## Liabilities:

Accounts Payable	<u>88,446</u>
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## Fund Balances:

Reserved -	
Reserved for Encumbrances	152,639
Reserved for Long Term Receivables	<u>617,533</u>
Total Reserved Fund Balances	\$ 770,172
Unreserved Fund Balance	<u>4,947,161</u>
 Total Fund Balances	<u>5,717,333</u>
 Total Liabilities and Fund Balances	<u>\$5,805,779</u>

The notes are an integral part of the financial statements.

## DEPARTMENT OF TRADE AND ECONOMIC DEVELOPMENT

## GOVERNOR'S RURAL DEVELOPMENT COUNCIL

RURAL REHABILITATION TRUST FUND  
STATEMENT OF REVENUES, EXPENDITURES AND  
CHANGES IN FUND BALANCE  
June 30, 1987

Revenues

Investment Income	\$ 600,629
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Expenditures

## Current:

Personal Services	\$100,440
Consultant and Professional Technical Services	101,555
Travel	15,768
Rent	13,242
Printing	5,188
Communication	5,196
Supplies and Materials	1,857
Indirect Costs	22,278
Other	<u>1,100</u>
Total Current Expenditures	\$ 266,624

## Grants and Subsidies:

Individuals	\$ 11,792
School Districts	78,043
Local Special Districts	16,263
Other Governments	15,000
Nongovernmental Organizations	<u>182,190</u>
Total Grants and Subsidies	<u>303,288</u>

Total Expenditures	<u>\$ 569,912</u>
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Excess of Revenues over Expenditures	<u>30,717</u>
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Other Financing Sources (Uses)

Operating Transfers Out	<u>&lt; 3,500,000&gt;</u>
Excess of Revenues and Other Sources over (under) Expenditures and Other Uses	<u>&lt; 3,469,283&gt;</u>
Fund Balance, July 1, 1986	<u>9,186,616</u>
Fund Balance June 30, 1987	<u>\$5,717,333</u>

The notes are an integral part of the financial statements.

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RURAL REHABILITATION TRUST FUND  
NOTES TO THE FINANCIAL STATEMENTS  
June 30, 1987

(1) Organization and Significant Accounting Policies

Authorizing Legislation

During fiscal year 1987, the Governor's Rural Development Council (the Council), a component unit of the State of Minnesota, operated pursuant to Minn. Stat. Section 116J.961. The Council administered the Rural Rehabilitation Trust Fund of the State of Minnesota established pursuant to Minn. Stat. Section 116J.955. Note 6 describes the subsequent elimination of the Council and establishment of the Rural Development Board.

The Governor's Rural Development Council was established to advise the Governor and the Legislature on matters of public policy relating to rural development, to identify prominent rural issues, and to formulate and advocate policies that serve the needs of the rural population of the state. The council consisted of 14 members, representing the various regions of the state and the Commissioner of Trade and Economic Development.

The council administered activities of the Rural Rehabilitation Trust Fund, including a rural development grant program, and provided technical help and rural development information services to state agencies, special districts, local governments, and interested citizens. They also entered into contracts with individuals to obtain the technical knowledge to properly run the programs.

Basis of Accounting

The financial activities of the council are accounted for as an expendable trust fund. The accompanying financial statements are presented on the modified accrual basis in accordance with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board.

(2) Cash and Investments

Cash of the Rural Rehabilitation Trust Fund is held in the State Treasury, commingled with other state funds. Minn. Stat. Section 9.031 requires that deposits be secured by depository insurance or a combination of depository insurance and collateral securities held in the state's name by an agent of the state. Such insurance and collateral shall be in amounts sufficient to ensure that the deposits do not exceed 90% of the sum of the insured amount and the market value of the collateral.

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Pursuant to Minn. Stat. Section 116J.955, the principal balance of the Rural Rehabilitation Fund is invested by the State Board of Investment. In accordance with Minn. Stat. Section 11A.24, fund investments consist primarily of banker's acceptances, governmental and governmental agency obligations, commercial paper, and repurchase agreements. The carrying amount (cost or amortized cost) of the Rural Rehabilitation Trust Fund investments at June 30, 1987 was as follows:

Federal agency obligations	\$2,700,000
Commercial paper	1,303,000
Other	<u>983,744</u>
Total	<u>\$4,986,744</u>

For all investments, carrying amount approximated market value at June 30, 1987. All investments are insured or registered or are held by the state or its agent in the state's name.

3) Notes and Loans Receivable

Notes receivable are stated at their principal amount. Interest on loans is recorded on an accrual basis. The Minnesota Department of Agriculture, through the Family Farm Security Loan Program, guarantees the loan balance held by the Rural Rehabilitation Trust Fund in the event of a borrower default.

(4) Operating Transfers Out

Laws 1987, Chapter 386, Article 2, Section 25 appropriated \$3,500,000 from the Rural Rehabilitation Trust Fund to the Agricultural Product Utilization Fund administered by the Greater Minnesota Corporation.

(5) Fund Balances

The reserved portion of fund balance indicates that a portion of the fund balance is not available for appropriation. Reserve for encumbrances represents amounts committed as of June 30, 1987 for future year expenditures. Reserve for long term receivables represents fund balance amounts which are not available to finance current expenditures. Unreserved fund balance represents financial resources available for current appropriation.

(6) Subsequent Events

Laws 1987, Chapter 386, abolished the Governor's Rural Development Council and created the Rural Development Board which operates pursuant to Minn. Stat. Chapter 116N. The board consists of commissioners of various state departments, agencies, and quasi-agencies, as

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well as six members from the general public. The general duties of the Board include investigating and evaluating new methods to enhance rural development and administration of a challenge grant program to encourage private investment, to provide jobs for low-income persons, and to promote economic development in the rural areas of the state. David Speer, Commissioner of the Department of Trade and Economic Development, serves as Chairman of the Rural Development Board. In addition, DTED staff provide administrative support to the Rural Development Board.

## **MANAGEMENT LETTER SECTION**



## DEPARTMENT OF TRADE AND ECONOMIC DEVELOPMENT

## GOVERNOR'S RURAL DEVELOPMENT COUNCIL

## I. CURRENT FINDINGS AND RECOMMENDATIONS

1. The former chairman of the Governor's Rural Development Council claimed and was reimbursed for unreasonable airfare expenses from Arizona to St. Paul to attend council meetings.

Thomas Johnson was a member of the Governor's Rural Development Council from 1979 to 1987, serving as Chairman from 1985 to 1987. Mr. Johnson resided in Milan, Minnesota. However, he moved to Arizona during certain winter months. While residing in Arizona, he would fly back to Minnesota for periodic council meetings. DTED reimbursed him for his airfare from Arizona to Minnesota.

According to Minn. Stat. Section 116J.961, council members must reside within the region they represent. Council members are entitled to reimbursement of travel expenses when attending to council business, in accordance with the Department of Employee Relations commissioner's plan. Mileage must be for the most direct route from the employee's work station to the travel destination. Since board members are not assigned to a permanent work station, mileage is normally paid from their permanent residence to the travel destination. As such, the state would be responsible for reimbursing Mr. Johnson for his expenses from his residence in Milan, Minnesota to the meeting location. The travel regulations do not specifically address reimbursement of expenses from a temporary residence in an out-of-state location to a meeting within Minnesota. There may be certain unusual circumstances where such a reimbursement would be allowable, but we do not believe it is reasonable or prudent to continue this practice on an on-going basis. A personal decision to live outside the state for a portion of the year does not obligate DTED to pay expenses from that location. Reimbursing expenses in this manner increases the risk of mixing personal and public business.

During fiscal years 1985 through 1987, Mr. Johnson was reimbursed \$1,673.22 for round-trip airfare from Arizona to St. Paul as shown on the following chart. We believe it would have been more reasonable to reimburse him \$466.56 for mileage from his Minnesota residence to St. Paul.

Dates	Description	Amount Reimbursed	Mileage Allowed	Mileage Difference
2/14-15/85	Round-trip Mesa, AZ to St. Paul	\$ 315.00	\$ 77.76	\$ 237.24
1/27-29/86	Round-trip Phoenix, AZ to St. Paul	198.00	77.76	120.24
2/20-21/86	Round-trip Phoenix, AZ to St. Paul	183.34	77.76	105.58
2/27-28/86	Round-trip Phoenix, AZ to St. Paul	238.88	77.76	161.12
1/19-21/87	Round-trip Phoenix, AZ to St. Paul	358.00	77.76	280.24
1/28-30/87	Round-trip Phoenix, AZ to St. Paul	380.00	77.76	302.24
TOTAL		<u>\$1,673.22</u>	<u>\$466.56</u>	<u>\$1,206.66</u>

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RECOMMENDATION

- DTED should discontinue reimbursing board members for travel expenses from out-of-state locations as a routine practice. A more reasonable practice would be to determine eligible amounts based on their Minnesota residence, with exceptions granted only on an emergency basis. The department should consult with the Attorney General regarding possible repayment of the excess amounts previously reimbursed.

2. The Family Farm Security Second Market loans are not monitored for prompt payment.

Family Farm Security Loans to farmers are 90 percent guaranteed through the Family Farm Security Loan Program administered by the Minnesota Department of Agriculture. The Department of Trade and Economic Development (DTED) purchased the guaranteed portion of a number of these loans on the secondary market in 1982. At June 30, 1987, the principal value of the loans owned by DTED was \$558,369.

Loan participants make payments to their lender banks, who in turn pay 90 percent to DTED. The banks report to DTED the portion of each payment which represents principal and interest. The Fiscal Services Division of DTED receives the payments and is responsible for recording and depositing them; however, no one is responsible for monitoring whether the payments are being made promptly. At June 30, 1987, two of the six loans owned by DTED were in default. The Department of Agriculture was notified by the lending bank of one of the defaulted loans whose annual payment, due in December 1986, was not received. The status of the other defaulted loan was questioned by the DTED Community Development staff during a review of loan files after the division assumed responsibility for the program in July 1987. The loan was subsequently determined to be in default. The last payment on the loan had been made in August 1985.

According to the secondary market agreement between DTED and the primary lenders, if a borrower defaults on any payment for 180 days or more, DTED is required to notify the primary lender in writing of its intention to collect the guaranteed portion. The primary lender then has the option to repurchase DTED's portion of the loan. If the primary lender does not repurchase, DTED is required to notify the Department of Agriculture in writing, of the primary lender's failure to repurchase. The Department of Agriculture will then purchase the guaranteed portion. The Rural Rehabilitation Trust Fund will then be eligible to receive the remaining loan principal and accrued interest to the date of payment. Therefore, DTED, representing the Rural Rehabilitation Trust Fund, as the holder, should monitor the loan payments so that if borrowers default they can promptly notify the lender or the Department of Agriculture and receive the appropriate principal and interest.

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RECOMMENDATION

- DTED should establish a monitoring process to ensure timely receipt of Family Farm Security loan repayments.
- 3. The administration of grants awarded under the Governor's Rural Development Council should be improved.

The Council has awarded grants from the Rural Rehabilitation Trust Fund to units of government, public agencies, institutions, nonprofit organizations, and individuals. The funds are to be used to improve the quality of life of farm families or other low-income rural residents in Minnesota, carry out agricultural or rural development projects, as well as to assist farmers and their families obtain on-the-job training, participate in intern or educational training programs, and further their education and improve their skills in farm service management. Two types of grants were available from the GRDC. Seed grants were one year, one time grants, which were limited to 30 percent of the total project costs, or \$10,000 whichever is less. Demonstration grants were one year grants which could be continued for the next two years. The first year grant award limit was \$60,000; the second year limit was \$40,000; and the third year limit was \$25,000. Total grant disbursements in fiscal year 1987 totalled \$303,288. Our review of this program disclosed several control weaknesses:

- The demonstration grant agreements between DTED and the grantees require each grantee to submit quarterly reports. Three of the four demonstration grants tested were missing at least one of the required quarterly reports. The reports reviewed did not identify the actual dates the reports covered. Additionally, documentation was not available to indicate that reports were being reviewed as received. Procedures should be implemented to monitor the receipt and review of quarterly reports. In addition, specific dates should be included on the quarterly reports to ensure the correct time period is being reported on and to allow comparisons with budgeted amounts.
- The grantees are required to submit letters of commitment with their application for all local match, whether cash or in-kind. Two of the four grants tested did not have letters of commitment on file. According to the grant guidelines, project applications that are incomplete or received after the deadline for application will not be considered for funding. Therefore, the applications tested should have been considered incomplete when they were received.

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- DTED requires the grantee to submit acceptable final audits of both grant funds and local cash and in-kind match funds. These audits must be based upon standard acceptable audit practices. Of the three closed grants reviewed, two of the projects did not have any report on file and one had submitted a compilation report instead of an audit report. Furthermore, we found no procedures to monitor the submission of audit reports.
- DTED staff stated that they perform on-sight visits of each grantee approximately once a month and keep in continual phone contact with each grantee. However, no documentation was available to indicate any on-sight visits or phone conversations had taken place. Proper documentation should be on file for all on-sight visits and monitoring-type phone conversations including a schedule of visits, a description of what was reviewed, any problems noted, and how the problems were resolved.

DTED staff will continue to provide administrative support for current and future grant programs administered by the Rural Development Board. It is important that adequate controls be developed to ensure proper administration of the programs.

RECOMMENDATIONS

To improve internal controls over Rural Rehabilitation Trust Fund grants, DTED should:

- develop procedures to ensure timely submission and review of quarterly reports from grantees;
- ensure that appropriate match was provided for the grants in question;
- develop procedures to monitor the receipt and review of final audit reports; and
- ensure that adequate documentation is maintained for all reviews or monitoring visits completed.

Office of the Commissioner

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St. Paul, MN 55101-1421

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December 8, 1987

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

RE: Response to OLA Monitoring Report Dated December 1, 1987

Dear Mr. Nobles:

The purpose of this letter is to provide you with a response to your recent monitoring letter. The format for this letter will be to quote findings and then follow with a specific response from the Department of Trade and Economic Development (DTED).

Finding One - "The former chairman of the Governor's Rural Development Council claimed and was reimbursed for unreasonable airfare expenses from Arizona to St. Paul to attend council meetings."

Recommendation- DTED should discontinue reimbursing board members for travel expenses from out-of-state locations as a routine practice. A more reasonable practice would be to determine eligible amounts based on their Minnesota residence, with exceptions granted only on an emergency basis. The department should consult with the Attorney General regarding possible repayment of the excess amounts previously reimbursed.

DTED Response - The Department will implement immediately the recommended travel reimbursement policy. In addition, the department will refer immediately the issue of the former chair's travel expenses to the Attorney General's Office for resolution.

Finding Two - "The Family Farm Security Second Market loans are not monitored for prompt payment."

Recommendation- DTED should establish a monitoring process to ensure timely receipt of Family Farm Security loan repayments.

DTED Response - Staff of the newly created Rural Development Board within the Community Development Division will implement immediately necessary monitoring procedures to ensure that the Family Farm Security Second Market loans purchased by the now defunct Governor's Rural Development Council are current according to amortization schedules and that required action is taken promptly should the borrower default.

Finding Three - "The administration of the grants awarded under the Governor's Rural Development Council should be improved."

Recommendation- To improve internal controls over Rural Rehabilitation Trust Fund grants, DTED should:

- develop procedures to ensure timely submission and review of quarterly reports from grantees;
- ensure that appropriate match was provided for the grants in question;
- develop procedures to monitor the receipt and review of final audit reports; and
- ensure that adequate documentation is maintained for all reviews or monitoring visits completed.

DTED Response - Due to the status of grants made by the Governor's Rural Development Council, it would be difficult to retroactively perform all those functions that should have been performed during the review, award and administrative processes by the staff of the former Council. However, staff of the Rural Development Board will implement procedures and make reasonable efforts to close out any active grants and to request any missing final reports for all grants.

In addition, in developing future programs for the newly created Rural Development Board, staff will implement internal controls consistent with the OLA recommendations contained in the OLA monitoring report.

We have found all the recommendations contained in the OLA Monitoring Report dated December 1, 1987, to be reasonable. We feel that this audit was necessary and will be beneficial to the department in formally closing out the activities of the former Governor's Rural Development Council. The cooperation of your staff has been appreciated.

Sincerely,

  
David Speer  
Commissioner