DEPARTMENT OF FINANCE
MANAGEMENT LETTER
FISCAL YEAR 1987

FEBRUARY 1988

Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

88-16

Veterans Service Building, Saint Paul, Minnesota 55155 • 612/296-4708

STATE OF MINNESOTA
OFFICE OF THE LEGISLATIVE AUDITOR
VETERANS SERVICE BUILDING, ST. PAUL, MN 55155 • 612/296-4708
JAMES R. NOBLES, LEGISLATIVE AUDITOR

Mr. Thomas J. Triplett, Commissioner
Department of Finance
309 State Administration Building
St. Paul, Minnesota 55155

Dear Commissioner Triplett:

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 1987 financial statements and material federal programs. The scope of our work has been limited to:

- those aspects of your department which have material impact on any of the state's various funds and account groups shown on the financial statements;
- the centralized responsibilities relating to federal funds in the areas of cash management and indirect costs;
- the general EDP controls over Finance systems; 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, 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 1987. The federal government is ultimately responsible for determining resolution of Single Audit recommendations. The appropriate federal program agency staff will contact your agency to review your efforts toward corrective actions for 1987 and prior years. They will also notify you of their final resolution.

The main text of this management letter contains our findings developed during this audit. Attachment I is a summary of the progress on the audit recommendations included in our management letter to your department last year.

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

1. Procedural changes are required to improve the financial reporting accuracy of the General Fixed Asset Account Group.

Land, equipment, construction-in-progress, and buildings of governmental funds are reported in the Schedule of General Fixed Assets By Sources in the state's Comprehensive Annual Financial Report. As of June 30, 1987 the total balance of the General Fixed Asset Account Group (GFAAG) was $1.3 billion, including additions during the fiscal year of $74 million.

For financial reporting purposes, state agencies certify construction-in-progress (CIP) amounts to the Department of Finance at fiscal year end. In nine project certifications tested, audit adjustments of $554,473 were required because agencies inappropriately included equipment expenditures in the CIP certifications. These expenditures were already capitalized as equipment in the GFAAG by the DOF and were therefore being double counted. Other inappropriate expenditures may have also been included in the agency certifications of CIP. However, without knowing the methods or accounting reports used by the agencies to complete the certifications, and because agencies are not required to provide more detailed support for the certifications submitted, additional double counting could have occurred and not been detected.

The Department of Finance (DOF) summarizes financial information by fund, function, and activity for the state's financial report through the use of computerized spreadsheets. For fiscal year 1987, three audit adjustments of $1,731,311, $630,800, and $198,325 were required to correct input errors to either the wrong fund or activity on the applicable schedule. DOF should consider options for the detection of input errors including reconciling monthly data to year end reports from the statewide accounting system or the Fixed Asset Record Management (FARM) system, or double checking or independently verifying the input of material amounts.

Currently, the funding source on the FARM system cannot be changed to account for transfers of assets between state departments when no money is exchanged. Therefore, the DOF staff manually record the change in funding source on their records. Since the FARM system is used by Finance to account for retirements under the current system, the asset value is again subtracted from the original funding source upon retirement. The asset remains in the fund it was transferred to after retirement.

Ideally, the funding source on the FARM system should be changed to properly account for these transfers. If FARMS cannot be changed or the cost of the system modifications would be prohibitive, the DOF needs to maintain detailed recorded on asset transfers to supplement FARMS. These detailed records would have to be used to determine the proper funding source upon retirement.

While the weaknesses noted above do not currently have a material impact on the GFAAG, they should be addressed to assure that they do not cause material misstatements in the future.

RECOMMENDATIONS

- The Department of Finance should develop more detailed procedures for state agencies to follow in completing CIP certifications to ensure that inappropriate expenditures are not included.

- Internal control over the accuracy of data entered on the DOF fixed asset spreadsheets should be improved.

- If equipment is transferred between state agencies at no cost, and the funding source of the equipment is changed in the DOF fixed asset records to reflect the transfer to the new department, documentation should be maintained so that when the asset is retired it can be removed from the correct fund.

2. State agencies have not uniformly followed up on subrecipient audit coverage.

In Fiscal Year 1987, the State of Minnesota received approximately $1.9 billion in federal financial assistance for various programs. Approximately $700 million of these funds were subgranted to local levels of government or nonprofit organizations. The Single Audit Act of 1984 requires that the state and subrecipients have appropriate audits of federal financial assistance. The state is responsible to monitor its subrecipients to ensure adequate audit coverage. The Act, in Section 7502(e)(1) provides:

> "Each State and local government subject to the audit requirements of this chapter, which receives Federal financial assistance and provides $25,000 or more of such assistance in any fiscal year to a subrecipient, shall--
>
> (A) if the subrecipient conducts an audit in accordance with the requirements of this chapter, review such audit and ensure that prompt and appropriate corrective action is taken on instances of material noncompliance with applicable laws and regulations with respect to Federal financial assistance provided to the subrecipient by the State or local government; or
>
> (B) if the subrecipient does not conduct an audit in accordance with the requirements of this chapter--
>
> (i) determine whether the expenditures of Federal financial assistance provided to the subrecipient by the State or local government are in accordance with applicable laws and regulations; and
>
> (ii) ensure that prompt and appropriate corrective action is taken on instances of material noncompliance with applicable laws and regulations with respect to Federal financial assistance provided to the subrecipient by the State or local government."

The Department of Finance is responsible for coordinating the subrecipient monitoring system. Finance has attempted to identify all subrecipients who would be required to have audits. They have directed state agencies to include a provision in subrecipient grant agreements which requires entities receiving over $25,000 in federal funds during a fiscal year to have single audits of those funds. The State Auditor's Office is to receive a copy of all subrecipient audit reports. They review the reports for compliance with the Single Audit Act and other applicable guidelines and determine whether the audits are acceptable or unacceptable. The State Auditor publishes a report each year detailing the results of this review. The individual state agencies are responsible for following up and resolving any audit findings or questioned costs identified in the audit reports relating to programs they administer. Finance has also designated state cognizant agencies responsible for resolving cross-cutting findings in subrecipient audit reports. Cross-cutting findings are those findings that affect the programs of more than one state agency.

Some state agencies have established procedures and systems to review audit coverage and resolve applicable findings. However, certain problems with subrecipient monitoring were identified in other agencies and will be reported in the individual management letters for those agencies. We did identify one area where we believe further clarification of agency responsibilities by Finance is required. There has not been a formal determination of which agencies are responsible for follow-up and what action should be taken if a subrecipient either does not have the required audit or if its audit is determined to be unacceptable by the State Auditor. In his report on subrecipients for the year ended June 30, 1986, the State Auditor determined that 11 audit reports were not received, and of the 676 received, 138 were unacceptable.

The state has certain options when there is inadequate audit coverage. State agencies could establish alternative procedures to ensure the proper expenditure of federal funds as provided in Subd. B of Section 7502(e)(1) of the Single Audit Act. Technically the state is not currently complying with Subd. B. In the past, Finance has concentrated on identifying subrecipients, communicating subrecipient audit requirements, and establishing a mechanism for processing subrecipient audit reports. It has not been practicable to pursue alternative monitoring procedures, as contemplated by Subd. B. The focus has rightfully been placed on obtaining as many subrecipient single audits as feasible.

The extent of subrecipient single audit coverage has grown significantly in the past few years. Therefore, we believe Finance should proceed to design a policy and establish a direction for state agencies to satisfy the requirements of Subd. B when acceptable subrecipient single audits are not received. The reasons for unacceptable audits vary. Some issues may easily be resolved by communicating with the entity or its auditor regarding the problem area. Other issues may require more in-depth review.

In establishing their policy, Finance should consider:

- possible ways to remedy past unacceptable single audits;

- current monitoring activities performed by state agencies which may satisfy Subd. B; and

- possible actions against subrecipients or their auditors if they continue to provide unacceptable single audits.

RECOMMENDATIONS

- The Department of Finance should assign responsibility for following up on subrecipient audits not completed or determined to be unacceptable.

- Finance should develop general guidelines addressing actions which should be taken by agencies to resolve these issues. The guidelines should address when a state agency should consider performing additional audit work to ensure proper expenditure of federal funds.

3. The Department of Finance needs to improve controls over payroll expense transfers.

Payroll expense transfers are used to correct payroll posting errors, such as charges to the wrong allotment account (AID) or fiscal year. Agencies complete a payroll expense transfer form explaining the error and indicating the necessary action to be taken. They also complete a precertification form which indicates the total payroll transfers input into the statewide accounting system (SWA) for the pay period. An authorized person is to sign the payroll expense transfer and both forms are sent to the Department of Finance Audit Control section for review.

The Audit Controls section verifies that the payroll expense transfers were input correctly by reconciling the balance on the precertification report to a SWA output report. They also verify that the reason for the transfer is indicated on a sample of forms.

Policy 07:04:15 of the Payroll/Personnel manual states that the Audit Control section is responsible for determining the propriety of payroll expense transfers. Currently, the Audit Control section has not assured itself that they have received a properly authorized payroll expense transfer form. The Audit Control section should have a listing of authorized signatures. Our testing indicated that authorized signatures were not verified. Without a properly authorized payroll expense transfer form, the Audit Control section has no evidence to support the propriety of the transfer. Their present testing of a sample of forms could be improved by confirming that the person authorizing the document has been delegated this authority, and determining the reasonableness of the explanation for the transfer.

An improper payroll expense transfer could result in an employee being paid from state or federal appropriations designated for another intent. While the Audit Control section may not be able to determine this from the payroll expense transfer form, improved procedures could alert them to potential problems. If they question the propriety of a transaction, they could request further documentation from the agency.

RECOMMENDATION

- The Department of Finance Audit Control section should verify that payroll expense transfers are supported by a properly authorized payroll expense transfer form. For their sample testing of documents, they should verify that the authorized signature is appropriate and that the explanation for the transfer is reasonable.

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

Sincerely,

James R. Nobles
Legislative Auditor

John Asmussen, CPA
Deputy Legislative Auditor

Attachment

February 25, 1988

Attachment

DEPARTMENT OF FINANCE

STATUS OF PRIOR AUDIT RECOMMENDATIONS
AND
PROGRESS TOWARD IMPLEMENTATION

Monitoring of indirect cost plans and reimbursement collections should be improved.

1. The Department of Finance should more closely monitor state agency activity and enforce compliance with Operating Policy and Procedure 06:03:22 relating to the recovery and accounting for agency and statewide indirect costs.

RECOMMENDATION SUBSTANTIALLY IMPLEMENTED. During fiscal year 1987, Finance increased its current monitoring efforts and also collected reimbursements due for prior fiscal year 1986, except for approximately $50,000.

Control over logonIDs for the statewide accounting system needs improvement.

2. The Department of Finance should monitor unused logonIDs and require IMB security officers to suspend the logonIDs if unused after a reasonable period of time.

RECOMMENDATION IMPLEMENTED. LogonID's are now monitored and suspended.

There is inadequate verification of investment securities held by the Federal Reserve Bank.

3. As part of their contractual arrangement, the Department of Finance should require First Trust Company to perform a periodic reconciliation of the securities owned by the state to the safekeeping records of the Federal Reserve Bank.

RECOMMENDATION IMPLEMENTED. During fiscal year 1987, First Trust Company made major changes in their recordkeeping system for the State's financial activity. These changes included reconciling their record of assets to the safekeeping records of the Federal Reserve Bank.

The allocation of income from the invested treasurers cash account is not based on the total income actually earned during the year.

4. The Department of Finance should allocate the total income earned by ITC based on the average cash balances of participating funds and accounts.

RECOMMENDATION IMPLEMENTED. Starting in April 1987, the income allocation to invested Treasurer's cash account participants was based on the ratio of total interest earned to the total average daily cash balance of the fund. The resulting rate is multiplied times the average daily cash balance of each participant.

STATE OF MINNESOTA
DEPARTMENT OF FINANCE
309 STATE ADMINISTRATION BUILDING
SAINT PAUL, MINNESOTA 55155

612-296-5900

February 25, 1988

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

Dear Jim and John:

Thank you for the opportunity to respond to your management letter containing the findings and recommendations resulting from your review of certain accounting procedures and controls in the Department of Finance during the 1987 statewide audit. Our response is enclosed.

We appreciate the work of you and your staff in the review of our department and the audit of the state's annual financial statements and federal program expenditure statements.

Sincerely,

Tom

Tom Triplett
Commissioner

DEPARTMENT OF FINANCE
RESPONSE TO LEGISLATIVE AUDITOR'S MANAGEMENT LETTER

1. FINDING:

Procedural changes are required to improve the financial reporting accuracy of the General Fixed Asset Account Group.

RESPONSE:

When we request year-end certifications of construction-in-progress from state agencies, we will make it clearer to the agencies that items capitalized as equipment should not be included. We will provide agencies with detailed procedures for preparing the data sheets, revise construction in progress data sheets to include documentation for sources of information, and discuss with state agencies the problems encountered in the past. This will be done at the time of the next year-end request.

We have begun to reconcile the fixed asset spreadsheet data to the PC records by fund, and we will begin immediately to double check the input of material amounts. We are also looking at the feasibility of downloading data from the Fixed Asset Record Management System (FARMS) and the Statewide Accounting System to reduce the need for manual input.

We are not responding to your comments concerning the inability to change the funding source in the FARMS to account for transfers of assets between state departments when no money is exchanged, since that system is the responsibility of the Department of Administration. We are no longer changing the funding source in the Department of Finance fixed asset records for such transfers, unless the transfers are between governmental and nongovernmental funds. Our records will then agree with the FARMS, and retirements will be from the fund in which the asset is recorded.

2. FINDING:

State agencies have not uniformly followed up on subrecipient audit coverage.

RESPONSE:

Over the last several years, the Department of Finance has notified agencies of the requirements of the Single Audit Act and OMB Circular A-128. This includes the requirement to determine whether the subrecipient spent federal assistance funds in accordance with applicable laws and regulations, either by reviewing an audit of the subrecipient made in accordance with Circular A-128, Circular A-110, or through other means if the subrecipient has not yet had such an audit (e.g., in memo dated May 20, 1985, to Single Audit Coordinators).

In addition, about two years ago, we again reminded Single Audit Coordinators that state agencies are responsible for assuring that subrecipients have the required audits and that any audit findings are resolved. We asked agencies to send us copies of their procedures for requiring subrecipient audits and for resolving any audit findings. Not all agencies had written procedures at that time. It is our understanding that some agencies are following up on unacceptable audits by requesting a revised audit report or by notification that the following year's audit report must meet the requirements. We will, prior to June 30, again request that agencies send us copies of their procedures for requiring subrecipient audits, and will review them for adequacy.

Because of the differing nature of the various agencies' programs, the sanctions available to agencies for dealing with uncompleted or unacceptable audits could vary from agency to agency. Also, we do not think alternative monitoring procedures are practical other than possibly as a last resort.

We will consult with our federal lead cognizant audit agency and with state agencies with subrecipients in order to develop guidelines addressing actions that agencies should take to resolve uncompleted or unacceptable audits.

3. FINDING:

The Department of Finance needs to improve controls over payroll expense transfers.

RESPONSE:

The Audit Control section has been reviewing a computer-selected sample of expense transfers since December 1986. The review has included determining if the explanation for the transfer is reasonable. We will begin immediately verifying the authorized signatures on the expense transfers included in our sample.