DEPARTMENT OF FINANCE
FINANCIAL AND COMPLIANCE AUDIT
FOR THE FOUR YEARS ENDED JUNE 30, 1988

MARCH 1989

89-16

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

Senator Randolph W. Peterson, Vice-Chairman
Legislative Audit Commission

Members of the Legislative Audit Commission

and

Mr. Thomas J. Triplett, Commissioner
Department of Finance

Audit Scope

We have completed a financial and compliance audit of the Department of Finance for the four years ended June 30, 1988. We have issued separate management letters, dated February 20, 1986, February 25, 1987, and February 25, 1988, as part of our Statewide Financial and Single Audit work in the department for fiscal years 1985, 1986, and 1987. Section I provides a brief description of the department's 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 Government Auditing Standards, and accordingly, included such audit procedures as we considered necessary in the circumstances. Field work was completed on January 31, 1989.

The objectives of the audit were to:

- express an opinion on the state's financial statements for the year ended June 30, 1988;
- study and evaluate the department's internal control systems, including revenues, expenditures, assets, and liabilities;
- verify that financial transactions were made in accordance with applicable laws, regulations, and policies, including Minn. Stat. Chapter 16A, and other finance-related laws and regulations; and
- determine the status of prior audit recommendations.

Management Responsibilities

The management of the Department of Finance is responsible for establishing and maintaining a system of internal accounting control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and costs of control procedures. The objectives of a control system are to provide management with a 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.

Because of the 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 the procedures may become inadequate because of the changes in conditions, or that the degree of compliance with the procedures may deteriorate.

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

Audit Techniques

During our audit we employed a variety of audit techniques. These included, but were not limited to, auditor observation, interviews with department staff, analytical reviews to identify unusual transactions or trends, and the examination of documentation supporting a representative number of transactions. Random sampling techniques were used to assure that representative samples of transactions were chosen. However, the use of random sampling did not prohibit us from reviewing additional transactions which may have come to our attention during the audit.

Status of Prior Audit Findings

The recommendations from the 1985 and 1986 Statewide Financial And Single Audits were resolved as discussed in the subsequent years' management letters. In addition, we reviewed the status of findings included in our audit report of the department for the period July 1, 1983 to June 30, 1984 (report dated April 1985) and the management letter for the 1987 Statewide Financial and Single Audit. We concur with the corrective actions you have taken resolving the three recommendations contained in the audit report and consider them implemented. We concur with the corrective actions you have taken for resolving findings #2 and #3 of the management letter and consider them implemented. Concerns regarding unresolved issues relating to management letter finding #1 are repeated in this report.

Conclusions

We have issued an unqualified opinion on the State of Minnesota's general purpose financial statements for the year ended June 30, 1988. Our audit opinion, dated December 1, 1988, is included in the state's Comprehensive Annual Financial Report prepared by the Department of Finance. Our audit opinion on the Supplemental Federal Programs Statements of Expenditures, dated January 31, 1989, will be included in the Financial and Compliance Report on Federally Assisted Programs prepared by the Department of Finance and our office.

In our opinion, except for the issues discussed in Section II, the Department of Finance's system of internal accounting control in effect on December 1, 1988, 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 and recorded properly.

In our opinion, for the four years ended June 30, 1988, the department administered its programs in compliance, in all material respects, with applicable finance-related laws and regulations.

Section II of this report contains the findings we developed during this audit. The recommendations are presented to assist you in resolving the audit findings and in improving accounting procedures and controls. We will be monitoring and reviewing your progress on resolving these findings after the dates projected for completion as identified in the response to this report.

We would like to thank the Department of Finance staff for their cooperation during this audit.

James R. Nobles
Legislative Auditor

John Asmussen, CPA
Deputy Legislative Auditor

January 31, 1989

DEPARTMENT OF FINANCE

TABLE OF CONTENTS

DEPARTMENT OF FINANCE

I. INTRODUCTION

The Department of Finance plans, analyzes, and manages the budget, financial operation, certain agricultural loan participations, and debt of the state. In addition, the department forecasts revenues, controls expenditures per law, and reports various financial information to the Governor, Legislature, and the public. It also assists state agencies in accomplishing their missions by providing financial services, consultation, and information. In order to fulfill these responsibilities, the Department of Finance employed approximately 124 staff during fiscal year 1988.

The department operates under the direction of a commissioner who is appointed by the Governor. During our audit period the department had four commissioners: Gordon M. Donhowe (January 3, 1983 - June 4, 1985), Jay Kiedrowski (June 5, 1985 - August 21, 1987), Nellie Johnson, Acting, (August 22, 1987 - October 20, 1987), and Thomas Triplett (October 21, 1987 - present).

Department operations are primarily financed through General Fund appropriations. The following schedule highlights the expenditures for the material General Fund programs administered by the department during the past three years:

	Year Ended June 30		
Program:	1988	1987	1986
Accounting and Operations	$4,568,484	$4,226,884	$4,077,264
Budget, Analysis and Control	1,905,488	1,464,137	1,278,661
Fiscal Management and Administration	1,183,243	1,322,041	1,483,744
Rural Farm Administration	241,484	183,466	5,414
Total Expenditures	$7,898,699	$7,196,528	$6,845,083

In addition, the department has administrative responsibility for various nonoperating accounts.

II. CURRENT FINDINGS AND RECOMMENDATIONS

1. Equipment balances in the general fixed asset account group are not supported by detailed subsidiary records.

Most of the state's land, equipment, construction-in-progress, and buildings are reported on the state's general fixed asset account group for external financial reporting purposes. As of June 30, 1988, the total balance of the general fixed asset account group was $1.4 billion, including an equipment balance of $341 million.

Prior to fiscal year 1985, detailed equipment records were maintained by the Department of Administration on the state property inventory system. Beginning in fiscal year 1985, the state converted to the fixed asset records management system (FARMS). This system was an attempt to provide more detailed and complete financial information for the state's equipment. However, as Administration converted equipment records to FARMS, it became apparent to the Department of Finance that the system had some inherent problems which would limit its usefulness for financial reporting purposes. Specifically, Finance is concerned about the timing of additions to FARMS and the accuracy of the information included.

Because of these problems, Finance has not used FARMS as a basis for equipment additions for the General Fixed Asset Account Group. The original beginning equipment balance was taken from the old state property inventory system in 1985. All subsequent additions have been determined through analysis of disbursements on the statewide accounting system. There is no detailed list of equipment to support the totals shown on the financial statements. While these problems have not yet had a material impact on the general fixed asset account group, they must be resolved in order to avoid material misstatements in the future.

RECOMMENDATION

- **Finance must have accurate, detailed equipment records to support the equipment balance reported in the general fixed asset account group.**

2. Agencies do not always comply with construction-in-progress guidelines established by the Department of Finance.

For financial reporting purposes, state agencies must certify construction-in-progress amounts to the Department of Finance at the end of each fiscal year. To aid agencies in determining which expenditures should be included, Finance has provided agencies with the state's betterment policy defining appropriate costs to be included within construction-in-progress, and detailed instructions for completing the year end certifications. The betterment policy requires agencies to split costs if a construction project includes both repair and betterments. In addition, agencies are to segregate construction-in-progress disbursements on their accounting records to facilitate financial reporting. Even though these certifications are the responsibility of the agencies, Finance still has overall responsibility for the construction-in-progress balance on the financial statements.

Finance has accepted construction-in-progress information from the Department of Transportation (Mn/DOT) even though the department appears not to have complied with the state's betterment policy. For example, Mn/DOT submitted a spreadsheet certifying over 260 projects for construction-in-progress at June 30, 1988. Nearly 40 percent of these projects had expenditures for the year of less than $1,000. Mn/DOT officials admitted that many of these projects were probably not betterments, or were probably completed and should not be included in construction-in-progress. However, Finance did not document their resolution of these questionable items. Even though the items are immaterial to the construction-in-progress balance on the financial statements, they ultimately affect the building records and, over a period of years, could cause an increased risk of misstatements in the future.

RECOMMENDATION

- **Finance should work with Mn/DOT to make sure that the betterment policy is available to and understood by Mn/DOT employees.**

3. State agency contracts and leases are authorized and encumbered after the effective start date of the agreements.

The Department of Administration authorizes all agency contracts and leases. The Department of Finance subsequently encumbers agency funds from the authorized contract or lease document. Minn. Stat. Section 16A.15, Subd. 3 requires that funds be encumbered prior to obligation by the state agency. However, many agency contracts and leases are authorized and encumbered after the effective start date, and after financial obligations have been incurred by state agencies. If an obligation is incurred before funds are encumbered, the Department of Finance requires the agency to document justification in a letter to the department (commonly referred to as a "Chapter 16A letter") in accordance with operating policy and procedure 06:04:18. The use of these letters is increasing. Over 800 Chapter 16A letters were received by the Department of Finance during fiscal year 1988. Moreover, we found additional exceptions which were not justified in writing to the Department of Finance.

State agencies prepare and submit consultant and professional service contracts to the Department of Administration, contract management section, for final approval prior to encumbrance of funds by the Department of Finance. Four of a sample of 37 (11%) contracts tested had obligations incurred prior to the date when funds were authorized and encumbered, without a Chapter 16A letter which justified the reason for the delay. Contract management staff indicated that it is difficult for them to identify obligation dates but they can screen the effective period of contracts for significant delays between effective start date and contract authorization.

In the Department of Administration, real estate management division, obligations for leases are incurred before lease contracts are finalized. Real estate management is responsible for preparing and negotiating state agency leases for space rental. The division provides final approval on the lease prior to encumbrance of funds by the Department of Finance. Thirty-seven of a sample of seventy-nine (47%) leases examined were authorized and encumbered after the effective start date of the lease. One lease extension effective January 1, 1988 was not authorized until April 1988 and encumbered in May 1988. Another lease included an amendment for a $62,620 remodeling job which was completed before all required authorizations were provided. After-the-fact authorization was obtained but this creates a risk that work may be performed without management's approval or without adequate funding.

We recognize that in certain situations, obligations may be incurred before funds are encumbered. Because of this, Finance must continue to have a Chapter 16A justification process. However, the use of Chapter 16A letters should be limited only to unique situations and should not be allowed to become routine.

RECOMMENDATION

- **The Department of Finance should work with the Department of Administration and with state agencies to verify that all contracts are authorized and encumbered prior to the effective start date of the contract or lease.**

State of Minnesota
Department of Finance

400 Centennial Building
658 Cedar Street
St. Paul, Minnesota 55155
(612) 296-5900

March 8, 1989

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 financial and compliance audit report containing the findings and recommendations resulting from your audit of the Department of Finance for the four years ended June 30, 1988. 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 Triplett
Commissioner

DEPARTMENT OF FINANCE

RESPONSE TO LEGISLATIVE AUDITOR'S MANAGEMENT LETTER

1. FINDING:

Equipment balances in the general fixed asset account group are not supported by detailed subsidiary records.

RESPONSE:

The Department of Finance (DOF) produces a monthly Statewide Accounting System (SWAS) - Fixed Asset Record Management System (FARMS) reconciliation report which lists the differences between the two systems for new purchases. This report is distributed to agencies at the beginning of each month. We request agencies to resolve the differences and make appropriate corrections. Several agencies are behind in resolving the differences shown on this report and have not given the equipment inventory function a very high priority. DOF is working with these agencies to resolve these differences.

In addition, DOF produces a personal computer report at year end by agency that shows the differences between the inventory that is shown on FARMS and the inventory that is shown in the SWAS. This enables us to monitor the materiality of the variance both in total and by agency.

DOF will continue to work with state agencies to resolve differences between the SWAS and FARMS. We will also work with the Department of Administration to assist agencies in resolving problems they have with FARMS, to promote a regular training program for FARMS, and in getting all agencies to place a higher priority on the inventory function.

2. FINDING:

Agencies do not always comply with construction-in-progress guidelines established by the Department of Finance.

RESPONSE:

The Department of Finance recognizes the inexact methods used to accumulate construction in progress information but feel that the results provide materially correct information. We currently review the information provided by the agencies for construction in progress (CIP) and frequently raise questions about the amounts and the propriety of classifying projects as construction in progress. We usually eliminate those that are clearly not appropriate. We will continue these efforts and expand them where necessary. We will document where we contacted the agency to verify information and will also document the reasons for our decisions.

We chose to accept the small projects amounts for DOT, even though we recognized that some of the projects might be inappropriate, because of the immateriality of the amounts involved. (For those DOT projects less than $1,000, the CIP total was only $31,292. Total CIP for DOT was $4,407,914 and for the state, $36,489,351.) By doing so we were able to use information from DOT's cost accounting and building inventory systems as the basis for CIP and building inventory. We will work with DOT to make sure that their employees understand the state's betterment policy. We will also work with them to help identify and eliminate those projects which do not meet the policy. We expect that these steps will allow us to continue to use their records for buildings and CIP. This will avoid additional work on their part to accumulate the information separately from their current process.

We welcome additional information on where there are problems with the CIP information provided so that we can work with those agencies having problems.

3. FINDING:

State agency contracts and leases are authorized and encumbered after the effective start date of the agreements.

RESPONSE:

We share your concerns with the growing number of contracts and leases processed in violation of Minnesota Statutes Section 16A.15, Subdivision 3. The Department of Finance (DOF) has concentrated its efforts on ensuring that agencies process the requisition transaction for contracts and leases prior to obligating the state, to ensure that funds are set aside to process the encumbrance.

It has been our policy to review the start date shown in the contract and the contractor's signature date. If the later of these dates is more than 30 days before the date the contract is received by the Encumbrance Unit, the contract is returned to the agency to obtain the actual start date of the contract. If work has already started, we require that a 16A letter be submitted when the contract is returned for encumbering. We will provide additional details on this policy and the reasons for it to your staff. We would appreciate your response as to whether the policy is reasonable.

We will follow up with the Department of Administration and with those agencies that have repeated 16A.15 violations to assure that they are taking the necessary steps to eliminate these violations in the future.