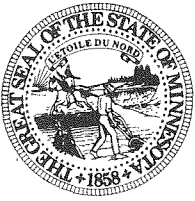

**INDIAN AFFAIRS COUNCIL
FINANCIAL AND COMPLIANCE AUDIT
FOR THE THREE YEARS ENDED JUNE 30, 1988**

JUNE 1989

**Financial Audit Division
Office of the Legislative Auditor
State of Minnesota**

89-43



STATE OF MINNESOTA

OFFICE OF THE LEGISLATIVE AUDITOR

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

JAMES R. NOBLES, LEGISLATIVE AUDITOR

Senator John E. Brandl, Chairman
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Darrell Wadena, Chairman
Indian Affairs Council

and

Mr. Roger Head, Executive Director
Indian Affairs Council

Audit Scope

We have completed a financial and compliance audit of the Indian Affairs Council for the three years ended June 30, 1988. Section I provides a brief description of the council'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.

Internal Accounting Control Systems

One objective of this audit was to study and evaluate major internal accounting control systems; payroll, administrative disbursements, loans, grants, and receipts, at the council office, in effect as of March 31, 1989.

The management of the Indian Affairs Council 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 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.

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.

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Finance-Related Legal Provisions

Another objective of this audit was to verify that financial transactions were made in accordance with significant finance-related laws. The Indian Affairs Council is governed generally by Minn. Stat. Section 3.922. This section creates the council and establishes the general purpose for its financial transactions. Minn. Stat. Section 116J.64 and Minn. Rules Chapter 5100 define and set the operating procedures administering the Indian Business Loan Program. Minn. Stat. Section 273.165 imposes the severed minerals tax; twenty percent of the tax proceeds are dedicated to the Indian Business Loan Program. Laws of 1987, Chapter 404, Section 38 required the Indian Affairs Council to expend \$25,000 of its appropriation for the purpose of identifying, relocating, or preserving Indian burial grounds as described in Minn. Stat. Section 307.08.

Finally, the council is subject to certain general legal provisions which affect the financial management of most state agencies. Minn. Stat. Section 15.191 limits the use of imprest cash accounts to those authorized by the Department of Finance. Minn. Stat. Section 16A.15 requires that funds be encumbered before an obligation is incurred. Minn. Stat. Sections 16B.07-.08 require that competitive bids be let for all public contracts over \$15,000. Appropriations and other funds of the council are subject to the provisions of Minn. Stat. Chapter 16B. All employees of the council are in unclassified service as described in Minn. Stat. Section 3.922, Subd. 5. The unclassified employees follow the provisions of state bargaining agreements whose classifications are similar to the position held by the council employee. Plans applicable to the Indian Affairs Council include AFSCME, MAPE, the Managerial Plan, and the Commissioner's Plan.

The management of the Indian Affairs Council is 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 Indian Affairs Council. The purpose of our testing of transactions was to obtain reasonable assurance that the Indian Affairs Council had, in all material respects, administered its programs in compliance with the aforementioned laws and regulations.

Status of Prior Audit Findings

We have reviewed the status of the two audit findings included in our audit report for fiscal years 1984 and 1985, issued on May 5, 1986. The first finding concerned the maximum participation rate allowable for Indian Business Loans was exceeded. The second finding addressed the need for the council to strengthen internal control of fixed assets. In both instances, the council has implemented new procedures to resolve these issues.

Senator John E. Brandl, Chairman
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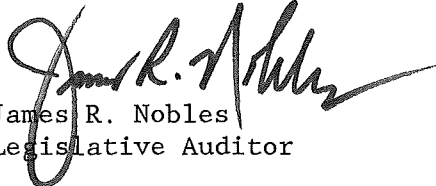
Conclusions

In our opinion, the Indian Affairs Council's system of internal accounting control in effect on March 31, 1989, 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.

Section II, findings 1 through 4, represent weaknesses in administration of the Indian Business Loan Program and in the accounting for gift receipts. We believe these weaknesses subject the Indian Affairs Council to unnecessary financial risks and should be corrected.

The results of our testing of transactions and records indicate that the Indian Affairs Council complied with the aforementioned finance-related legal provisions. Nothing came to our attention in connection with our audit that caused us to believe that the Indian Affairs Council was not in compliance with other applicable legal requirements.

We would like to thank the Indian Affairs Council's staff for their cooperation during this audit. Progress on resolving the findings discussed in this report will be reviewed within the next year.


James R. Nobles
Legislative Auditor


John Asmussen, CPA
Deputy Legislative Auditor

END OF FIELDWORK: April 13, 1989

REPORT SIGNED ON: June 20, 1989

INDIAN AFFAIRS 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
Tom Donahue	Audit Manager
John Wicklund, CPA	Auditor-In-Charge

EXIT CONFERENCE

The findings and recommendations in this report were discussed with the following staff of the Indian Affairs Council on May 10, 1989:

Roger Head	Executive Director
Charlotte White	Acting Administrative Assistant

INDIAN AFFAIRS COUNCIL

I. INTRODUCTION

The Indian Affairs Council (IAC), formerly the Indian Affairs Intertribal Board, was created by the legislature in 1963. The council membership consists of the elected chairman of each of the eleven tribal governments in the state, two at large members elected by Indian residents of Minnesota, and several ex-officio members, representing state agencies whose activities affect the Indian population. In addition, legislation enacted in 1976 created an Urban Advisory Council to advise the Indian Affairs Council on problems and concerns of urban Indians.

The council advises the Legislature on the nature of tribal governments, the relationship of tribal governments to the Indian people of Minnesota, and on other Indian affairs issues. The council also serves as a conduit and intermediary through which Indian issues and concerns are addressed to various state agencies.

The council administers the Indian Business Loan Program which offers Minnesota-based Indians the opportunity to establish or expand a business enterprise in Minnesota by providing low-interest loan capital. The council also works in close cooperation with the Minnesota State Historical Society and the state archaeologist to authenticate and identify Indian burial grounds.

The council operations are financed primarily through appropriations from the General Fund. During fiscal years 1988, 1987, and 1986, General Fund expenditures were \$327,239, \$288,064, and \$288,292, respectively.

The current IAC chairman is Darrell Wadena. The council appointed Roger Head, the current executive director, in 1981. The council maintains staff and office space in Bemidji and St. Paul.

INDIAN AFFAIRS COUNCIL

II. CURRENT FINDINGS AND RECOMMENDATIONS

1. A portion of funds allocated to the Indian Business Loan Program are not used.

The Indian Affairs Council (IAC), administers the Business Loan Program to Minnesota-based Indians. It provides the opportunity to establish or expand a business enterprise through the issuance of low-interest loans. Indians interested in applying for a loan through this program must submit an application to the IAC, which in turn sends it to the appropriate tribal council for approval or disapproval. The program is funded from taxation of severed mineral interests under Minn. Stat. Section 273.165. The loan program operates on a revolving account. Loan repayments and mineral tax receipts provide the amount available for allocation each year.

Available loan money is allocated annually among the 11 reservations. Each reservation has the authority to approve individual loans. However, only five of the eleven reservations have actively participated in the program from its inception. The Mille Lacs Reservation and three of the four Sioux reservations have not participated in the program. In addition, the Lower Sioux and the Red Lake Reservations have just recently decided to participate in the program.

Consequently, funds allocated to the inactive reservations have accumulated in the revolving account. For example, minerals taxes received during calendar year 1986 were \$110,451. Of this amount, \$47,420 (42.9 percent) was allocated to reservations which were not participating in the loan program. Legislation was passed during the 1989 session which enables the IAC to provide loans to eligible Indian members of the nonparticipating reservations. Our review of the council's minutes indicate a lack of direction concerning the use of allocated but unused funds. We believe this matter to be of importance to the council and should be formally addressed.

RECOMMENDATION

- The Indian Affairs Council should form a resolution concerning the usage of funds allocated to those reservations which do not participate in the Indian Business Loan Program.

2. Procedures to resolve delinquent loans in the Indian Business Loan Program are inadequate.

The delinquency of existing loans and effectiveness of collection procedures for the Indian Business Loan Program is of growing concern. Currently, the program has nine loans in severe delinquency with a total outstanding balance of over \$105,000. The IAC has contacted the Attorney General about foreclosure proceedings. Past foreclosure attempts have had little success, mainly due to the lack of significant collateral available

INDIAN AFFAIRS COUNCIL

to the state upon default. The IAC has attempted to use the provisions of the Revenue Recapture Act (Minn. Stat. Chapter 270A) for returns filed for the 1988 tax year. However, to date there have been no results.

Minn. Stat. Section 16B.06, Subd. 6 provides as follows:

Notwithstanding any other law, the state may not require an Indian tribe or band to deny their sovereignty as a requirement or condition of a contract with the state or an agency of the state.

The IAC has received an interpretation from the Attorney General informing them that the statute greatly restricts the remedies available upon default for delinquent loans when the business is located on a reservation. Since the IAC contracts with the various reservations to administer the program including setting the form and amount of the collateral securing the loan, the adoption of this statute prevents the state from suing these reservations to enforce the terms of the agreement made with them. The individual reservations must take the initiative to begin and enforce foreclosure proceedings against their members who have a delinquent loan; however, according to the Attorney General, state law prevents the IAC from forcing the reservations to do this. The executive director of the IAC has disagreed with this position, stating that contract law, not sovereignty is relevant in this matter.

The Attorney General has informed the IAC that the only sanction available to it is to refuse to distribute future funds to those reservations which have loans currently in default. They have also suggested that the IAC seek amendments to the existing rules for the program to conform with Minn. Stat. Section 16B.06, Subd. 6. We believe these are viable options that could be pursued by the IAC. The availability and adequacy of collateral securing these loans remains a major consideration in developing possible solutions to this problem.

RECOMMENDATION

- The Indian Affairs Council should work with the individual reservations to collect and resolve loans in delinquent status.

3. Controls over Indian Business Loan Program receipts need improvement.

Minnesota-based Indians applying for a loan under the Indian Business Loan Program can obtain capital for funding a new or existing business venture. The principal of the loan can be up to a maximum of 25 percent of the project's estimated cost. Repayment periods are limited to a period of 20 years, except for real estate purchases. For real estate purchases, the repayment period can be extended to 40 years.

Borrowers send monthly payments to the council's office in Bemidji. The payments are recorded and posted by the loan officer. The checks are subsequently mailed to the St. Paul office where they are endorsed and deposited. As a result, the delay between check receipt and deposit is about four to five days.

INDIAN AFFAIRS COUNCIL

Minn. Stat. Section 16A.275 mandates that receipts of \$250 or more should be deposited with the state treasury daily. The majority of IAC deposits are greater than \$250.

RECOMMENDATIONS

- The Indian Affairs Council should either set up a state depository in Bemidji, or instruct borrowers to send their loan payments to the St. Paul office.
- Receipts for the Business Loan Program should be restrictively endorsed at the time of receipt and promptly deposited.

4. The gift acceptance form is not being completed.

Minn. Stat. Section 3.922, Subd. 5 authorizes the Indian Affairs Council to apply for, receive, and spend gift fund monies. Because a portion of the council's General Fund appropriation is dependent upon the receipt of matching gifts, the council actively solicits gifts.

During fiscal year 1986 - 1988, the IAC received five gifts, ranging in amounts from \$1,500 to \$12,926. Two of these gifts were designated for general administrative purposes, while the other three gifts involved specific uses of the money toward activities consistent with the council's mission.

Statewide accounting operating procedure 06:06:07 requires agencies to develop an internal gift acceptance form. The purpose of this form is to determine whether the gift will benefit the state and conforms to agency objectives. Of the five gifts received, the IAC did not document these considerations for four gifts. For one gift, an interagency agreement with the Minnesota Department of Health to sponsor an AIDS workshop, the full council adopted a resolution supporting the activity.

RECOMMENDATION

- The Indian Affairs Council should develop and complete a gift acceptance form documenting the receipt and approval of all gifts.



State of Minnesota

INDIAN AFFAIRS COUNCIL

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June 9, 1989

Mr. Thomas Donahue
Audit Manager
State of Minnesota
Office of the Legislative Auditor
Veterans Services Building
St. Paul, Minnesota
55155

Dear Mr. Donahue:

The following represents the Minnesota Indian Affairs Council response to your findings and recommendations regarding our financial audit for the three fiscal years ending June 30, 1988.

We would particularly wish to express our appreciation of Mr. John Asmussen, CPA for his cooperation throughout our audit.

Sincerely:

A handwritten signature in cursive script, appearing to read "Roger Head".

Roger Head
Director

enc./jeb

c.c.
Darrell Wadena
Chairman Minnesota Indian Affairs Council

MINNESOTA INDIAN AFFAIRS COUNCIL

RESPONSE TO AUDIT FINDINGS AND RECOMMENDATIONS

1. A portion of the funds allocated to the Indian Business Loan Program are not used.

During the past legislative session, Representative Karen Clark introduced a bill which would allow the Indian Affairs Council to directly administer loans allocated to reservations which chose not to participate in the program on behalf of eligible tribal enrollees.

House File 1563 and Senate File 1401 were incorporate into the House Revisors Bill 1616 and passed. The Indian Affairs Council may now directly admimister and allocate those program loan funds allocated to reservations who chose not to participate in the Indian Business Loan Program.

The drawback regarding this legislation is that the Indian Affairs Council does not have a budget for administering this program. The loan program specifically states, and it is also the opinion of the Attorney General, that the loan money can not be used for administration costs. Such dollars to administer this program must be over and above the amount generated from the mineral rights account. Furthermore, the Indian Affairs Council also received a staff reduction of two positions from the agency budget. One federal position and one state position was eliminated. These reductions impact on the Indian Affairs Council's ability to meet these legislative requirements.

2. Procedures to resolve delinquent loans in the Indian Business Loan Program are inadequate.

The Indian Affairs Council began the Indian Business Loan Program in 1980. Rules were promulgated in 1981, and the first series of loans began in 1982. The concern that there are delinquencies in nine existing loans and that collection procedures are ineffective does not reflect the overall success of the program.

It is important to acknowledge that the Indian Business Loan Program is similiar to other Indian loan initiatives funded by the State of Minnesota and administered by various departments. The Minnesota Housing Finance Agency has an Indian home loan program for reservation and urban Indian housing.

The intent is the same. Indian people have difficulty in obtaining financing through conventional loan lenders. To qualify for a home loan or business loan through these lending institutions is restrictive at the best and discriminatory at the worst.

By offering lower down payments, lower interest rates, assistance with closing costs and the like, the term "creative financing" has opened the doors for approximately 900 Indian housing loans since 1976, and 42 Indian business loans since 1982.

79% of the Indian business loans are in good standing. Of the nine loans identified as delinquent, the majority of the loans are from one reservation and represent approximately 80% of the outstanding balance of \$105,000.

The Indian Affairs Council has used the appropriate procedures for collections and has documentation regarding collection efforts. The Attorney General's Office has been notified of the intent of foreclosure, however, it is the Attorney General's opinion that according to Minnesota Statute Section 16B.06, Subdivision 6:

Not withstanding any other law, the state may not require an Indian tribe or band to deny their sovereignty as a requirement or condition of a contract with the state or an agency of the state.

The Indian Affairs Council believes in this opinion, however, this opinion is not considered an appropriate arguement given that the tribes are not asked to specifically give up their sovereign rights to participate in the Indian Business Loan Program and that the loan is signed with the individual to secure or provide such collateral for the loan.

The matter of collection is more the case of available assets, and who is first receiver in foreclosure proceedings.

The Indian Affairs Council will pursue efforts with individual tribes to cooperate and develop successful loans programs which incorporate a mechanism for resolving loans in delinquent status.

3. Controls over Indian Business Loan Program receipts needs improvement.

The home office of the Indian Business Loan program was in the Bemidji office. As of July 1, 1989, the Indian Business Loan program will be move to the St. Paul Office. Therefore, all business loan payments will be sent to the St. Paul office directly and deposited promptly.

4. The gift form acceptance form is not being completed.

The Department of Finance is providing the Minnesota Indian Affairs Council with a "Gift of Acceptance Form" which will be used in the future along with a resolution from the Minnesota Indian Affairs Board supporting the acceptance of gifts.