

**DEPARTMENT OF FINANCE  
FINANCIAL AUDIT  
FOR THE YEAR ENDED JUNE 30, 1989**

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**APRIL 1990**

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

**90-21**



# SUMMARY

State of Minnesota  
Office of the Legislative Auditor  
Veterans Service Building • St. Paul, MN 55155  
612/296-4708

## DEPARTMENT OF FINANCE

### FINANCIAL AUDIT FOR THE YEAR ENDED JUNE 30, 1989

Public Release Date: April 4, 1990

No. 90-21

#### OBJECTIVES:

- EXAMINE THE FINANCIAL STATEMENTS OF THE STATE OF MINNESOTA.
- EVALUATE INTERNAL CONTROL STRUCTURE: payroll, administrative disbursements, master lease program, rural finance and beginning farmer loan programs, energy loan programs, grants to the University of Minnesota, and miscellaneous retirement fund grants.
- TEST COMPLIANCE WITH CERTAIN FINANCE-RELATED LEGAL PROVISIONS.

#### CONCLUSIONS:

Our opinion on the financial statements was included in the State of Minnesota's Comprehensive Annual Financial Report.

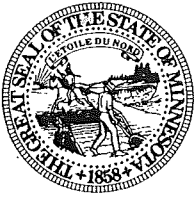
We found two areas where the internal control structure needed improvement:

- The department has not appropriately monitored agency compliance with indirect cost requirements.
- Controls over agency access to the statewide accounting and payroll systems need improvement.

We found that the department had complied with finance-related legal provisions, except for monitoring of indirect cost requirements.

Contact the Financial Audit Division for additional information.  
(612) 296-1730





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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Senator John E. Brandl, Chairman  
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Peter Hutchinson, Commissioner  
Department of Finance

Audit Scope

We have conducted a financial related audit of the Department of Finance as of and for the time July 1, 1988 to June 30, 1989. Our audit was limited to only that portion of the State of Minnesota financial activities attributable to the transactions of the Department of Finance, as discussed in the Introduction. We have also made a study and evaluation of the internal control structure of the Department of Finance in effect at June 30, 1989.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial activities attributable to the transactions of the Department of Finance are free of material misstatements.

As part of our study and evaluation of the internal control structure, we performed tests of the Department of Finance's compliance with certain provisions of laws, regulations, contracts, and grants. However, our objective was not to provide an opinion on overall compliance with such provisions.

Management Responsibilities

The management of the Department of Finance is responsible for establishing and maintaining an internal control structure. This responsibility includes compliance with applicable laws, regulations, contracts, and grants. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that:

- assets are safeguarded against loss from unauthorized use or disposition;
- transactions are executed in accordance with applicable legal and regulatory provisions, as well as management's authorization; and
- transactions are recorded properly on the statewide accounting system in accordance with Department of Finance policies and procedures.

Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

### Internal Control Structure

For purposes of this report, we have classified the Department of Finance's significant internal control structure policies and procedures in the following categories:

- payroll
- administrative disbursements
- master lease program
- rural finance and beginning farmer loan programs
- energy loan programs
- grants to the University of Minnesota
- miscellaneous retirement fund grants

For all of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk.

### Conclusions

Our study and evaluation disclosed the conditions discussed in findings #1 and 2 involving the internal control structure of the Department of Finance. We consider these conditions to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the entity's ability to record, process, summarize, and report financial data.


A material weakness is a reportable condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial activities being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We believe none of the reportable conditions described above is a material weakness.

Senator John E. Brandl, Chairman  
Members of the Legislative Audit Commission  
Mr. Peter Hutchinson, Commissioner  
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The results of our tests indicate that, except for the issue discussed in finding #1, with respect to the items tested, the Department of Finance complied, in all material respects, with the provisions referred to in the audit scope paragraphs. With respect to items not tested, nothing came to our attention that caused us to believe that the Department of Finance had not complied, in all material respects, with those provisions.

This report is intended for the information of the Legislative Audit Commission and management of the Department of Finance. This restriction is not intended to limit the distribution of this report, which was released as a public document on April 4, 1990.

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

END OF FIELDWORK: January 31, 1990

REPORT SIGNED ON: March 28, 1990





## DEPARTMENT OF FINANCE

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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
David Poliseno	Auditor-In-Charge
Mike Anderson, CPA	Staff Auditor
Chris Buse, CPA	Staff Auditor
Jean Mellett, CPA	Staff Auditor
Mary Senczek	Intern

### EXIT CONFERENCE

The findings and recommendations in this were discussed with the following staff of the Department of Finance on March 15, 1990:

Peter Hutchinson	Commissioner
Geri Benting	Assistant Commissioner, Accounting Services
Roy Muscatello	Director, Statewide Accounting
Rosalie Greeman	Director, Financial Reporting
Jim Stavsvick	Director, Systems Support
Bruce Reddemann	Director, Budget Operations
Bart Nelson	Budget Officer
Steve Olson	Security Officer



## DEPARTMENT OF FINANCE

### I. INTRODUCTION

The Department of Finance manages the accounting and financial operation, budgetary, and debt management activities of the state. In addition, the department forecasts revenues, controls expenditures in accordance with legal provisions, and reports various financial information to the Governor, the Legislature, and the public. It also assists state agencies by providing financial services, consultation, and information. In order to fulfill these responsibilities, the Department of Finance employed approximately 120 staff during fiscal year 1989.

The department operates under the direction of a commissioner who is appointed by the Governor. Tom Triplett served as commissioner during the audit period. Peter Hutchinson was appointed commissioner effective January 1, 1990.

Department operations are financed primarily from General Fund appropriations. The following schedule shows total departmental operating expenditures, including encumbrances, for fiscal year 1989:

Personnel Services	\$4,959,578
Data Processing	1,922,329
Supplies and Materials	477,690
Communications	323,658
Rent and Leases	276,130
Other	<u>647,505</u>
Total	<u>\$8,606,890</u>

Source: *Managers Financial Report as of September 2, 1989.*

In addition, the department has administrative responsibility for the following grant and loan programs:

- University of Minnesota grants
- Minnesota Historical Society grants
- Minneapolis Employees Retirement Fund grants
- energy loans
- rural finance loans
- beginning farmer loans

The Department of Finance, in conjunction with other state agencies, also provides centralized controls over the following areas for the state as a whole:

- cash receipts and disbursements
- payroll transaction processing
- investment purchases and sales and investment income allocation
- bonded debt and debt service expenditures
- budgets and appropriations
- statewide indirect cost recoveries

We include conclusions from our review of these centralized systems in our report on internal control for the state as a whole.

## DEPARTMENT OF FINANCE

### II. FINDINGS AND RECOMMENDATIONS

1. The Department of Finance has not appropriately monitored agency compliance with indirect cost requirements.

State agencies have not been making statewide indirect cost reimbursements on a quarterly basis as required by department policies. Total collections for fiscal year 1989 were \$9.8 million. However, only \$1.6 million was collected as of March 31, 1989. This was approximately \$2 million less than at the same point in fiscal year 1988. During fiscal year 1989, only eight agencies paid indirect cost reimbursements quarterly. Over 30 agencies did not make quarterly payments. As a result, the General Fund has not been reimbursed for these costs in a timely manner.

The Department of Finance is responsible for monitoring the collection of indirect costs in accordance with Minn. Stat. Section 16A.127. In our prior management letters to the department, we have made various recommendations relating to indirect costs. In March 1985, the department developed Operating Policy and Procedure 06:03:22, which addressed many of the concerns raised. The objective of the policy was to recover and account for agency and statewide indirect costs. The policy provides:

Reimbursement of statewide (and agency indirect costs for agencies where general support costs are fully appropriated) must be made periodically, at least quarterly. Final reimbursement must be made within 30 days after fiscal year end for those agencies whose indirect cost rate is based on direct salaries and wages. Final reimbursement must be made within 30 days after fiscal year closing for those agencies whose indirect cost rate is based on total direct costs.

The procedure further states that the "only exception to the quarterly schedule is if annual indirect costs are under \$2,000".

The Department of Finance needs to ensure timely reimbursement of indirect costs to the General Fund. Agencies have not been complying with the established policy. The department should follow-up on unpaid billings to verify compliance with the quarterly payment requirement.

Policy and Procedure 06:03:22 also requires state agencies which receive federal funds to submit indirect cost plans to the Department of Finance. The Department of Transportation, the Pollution Control Agency, and the Indian Affairs Board did not submit indirect cost plans to the department or to the applicable federal cognizant agency for fiscal year 1989. Transportation and Indian Affairs did not reimburse the General Fund for statewide indirect costs. The Pollution Control Agency paid the indirect cost reimbursement even though it had not received federal approval of its plan. To ensure that the state collects all eligible indirect cost reimbursements, the department should verify that agencies receiving federal funds have approved indirect cost plans.

## DEPARTMENT OF FINANCE

### RECOMMENDATIONS

- The Department of Finance should monitor statewide indirect cost reimbursements to ensure compliance with quarterly payment requirements.
- The department should verify that all agencies which receive federal funds have submitted appropriate indirect cost plans.

#### 2. Controls over agency access to SWA and PPS need improvement.

State agency controls over access to the Statewide Accounting (SWA) and Payroll/Personnel (PPS) systems need improvement in seven of eleven agencies we reviewed for fiscal year 1989. These agencies do not always:

- verify whether the authorizations given to individual operators by the Department of Finance are in agreement with the request for access forms;
- have a process for determining the number of operators needed for each type of transaction authority; or
- notify the Department of Finance of changes in operators' employment status.

The Department of Finance security files control clearance to SWA and PPS. Agencies must work through Finance to update the security files for new operators and cancel employees who transfer or leave state service. Agency oversight of access to process SWA and PPS transactions is essential to the overall system of control over these systems. Without the participation of the agencies in this effort, controls to prevent unauthorized access to agency and state resources and unauthorized payment transactions is weakened. The potential of unauthorized personnel obtaining unintended access to these systems, or of maintaining access to these systems after their job duties no longer justify such access, is increased.

The Department of Finance is ultimately responsible for SWA and PPS security. Because of the problems identified in our agency reviews, we believe the department should reinforce the need for appropriate security procedures with all state agencies.

### RECOMMENDATIONS

- The Department of Finance should send copies of the SWA and PPS security file detail reports to all state agencies. The department should require state agencies to verify that the authorizations given to agency operators agree with the access requested.

DEPARTMENT OF FINANCE

RECOMMENDATIONS (Continued)

- The department should require state agencies to review and justify the number of operators with SWA and PPS authorizations in line with agency needs and operators' duties.
- The department should require agencies to promptly notify them of changes in an agency operator's employment status which affect the operator's need for transaction authority.



**State of Minnesota  
Department of Finance**

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

March 19, 1990

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 Messrs. Nobles and Asmussen:

Thank you for the opportunity to respond to the findings and recommendations included in the report on your financial related audit of the Department of Finance for the year ended June 30, 1989. 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,

Peter C. Hutchinson  
Commissioner

Thanks for a  
first class  
job - we  
appreciate your  
help and  
support. P.

DEPARTMENT OF FINANCE  
RESPONSE TO LEGISLATIVE AUDITOR'S REPORT

1. FINDING:

The Department of Finance has not appropriately monitored agency compliance with indirect cost requirements.

RECOMMENDATIONS:

The Department of Finance should monitor statewide indirect cost reimbursements to ensure compliance with quarterly payment requirements.

The department should verify that all agencies which receive federal funds have submitted appropriate indirect cost plans.

RESPONSE:

The 3rd quarterly indirect cost payment/reimbursements are due on April 27, 1990. The Department of Finance will send out a notice to agencies reminding them of payment being due. If payments are not received on time, then a listing of agencies not making payment will be distributed to the assigned Executive Budget Officer. The Executive Budget Officer will work with agencies to assure that the payments are made.

This procedure will become a quarterly process to assure timely reimbursement of indirect costs to the General Fund.

During the review of agencies' annual spending plans, prior to allotment into the statewide accounting system, one of the criteria for non-general funds is to determine if an indirect cost plan is on file.

The Department of Finance has the procedure in place to determine which agencies have approved indirect cost plans. The problem arose due to the Finance Department letting two agencies enter their allotments on a promise that the indirect cost plans would be forthcoming. The follow up with the



agencies was not done after this to assure submission. The third agency thought that a three year indirect cost plan had been approved by their federal cognizant agency.

In the future the Department of Finance will prepare a listing of agencies needing approved indirect cost plans during the annual spending plan process and distribute to Executive Budget Officers, Budget Operations staff and the Agency head involved. It will be the responsibility of the Executive Budget Officer to assure that the indirect cost plans are prepared.

Two of the three agencies, cited for not having approved plans, now have approved indirect cost plans on file with the Department of Finance. We have contacted the third agency and a letter is to be coming stating when to expect their submission.

2. FINDING:

Controls over agency access to SWA and PPS need improvement.

RECOMMENDATIONS:

The Department of Finance should send copies of the SWA and PPS security file detail reports to all state agencies. The department should require state agencies to verify that the authorizations given to agency operators agree with the access requested.

The department should require state agencies to review and justify the number of operators with SWA and PPS authorizations in line with agency needs and operators' duties.

The department should require agencies to promptly notify them of changes in an agency operator's employment status which affect the operator's need for transaction authority.

RESPONSE:

At the time the Department of Finance enters new authorizations for system access, we will send a copy of the authorized transactions back to the agency. We will request that the agency verify the correctness of the list and notify us immediately if it is not correct. At the same time, we will remind the agency to

Department of Finance Response to Legislative Auditor's Report  
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notify us of any changes in the status of this or any other employee which affect the need for transaction authority. (Please note that we currently get regular system-generated reports of employees with system access who terminate employment in the authorizing agency.) We will implement this new procedure immediately.

We will annually send to each agency a list of the agency's employees with SWA and PPS transaction authority and the authorized transactions for each employee. We will ask each agency to review the need for the authority to continue, and ask the agency head to sign off to that effect. We will send the first list by March 31, and will send subsequent lists each January.