DEPARTMENT OF FINANCE
FINANCIAL AUDIT
FOR THE YEAR ENDED JUNE 30, 1990

APRIL 1991

Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

91-16

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

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, 1990

Public Release Date: April 5, 1991 No. 91-16

OBJECTIVES:

- EXAMINE THE FINANCIAL STATEMENTS OF THE STATE OF MINNESOTA.
- EVALUATE INTERNAL CONTROL STRUCTURE: payroll, data processing expenditures, master lease program, rural finance and beginning farmer loan programs, energy loan programs, bond allocation program, savings bond program, statewide indirect costs, University of Minnesota grants, Regional Transit Board grants, History Center construction grants, and tort claims.
- 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 one area where the internal control structure needed improvement:

- The department has not appropriately monitored agency compliance with indirect cost reimbursement requirements.

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

Representative Ann Rest, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. John Gunyou, Commissioner
Department of Finance

Audit Scope

We have conducted a financial related audit of the Department of Finance as of and for the year ended June 30, 1990. 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 during June 1990.

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 transaction 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.

<u>Internal Control Structure</u>

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;
- data processing expenditures;
- master lease program;
- rural finance and beginning farmer loan programs;
- energy loan programs;
- bond allocation program;
- savings bond program;
- statewide indirect costs;
- University of Minnesota grants;
- Regional Transit Board grants;
- History Center construction grants; and
- tort claims.

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.

<u>Conclusions</u>

Our study and evaluation disclosed the condition discussed in finding 1 involving the internal control structure of the Department of Finance. We consider this condition to be a reportable condition 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 the reportable condition described above is not a material weakness.

The results of our tests indicate that, except for the issue discussed in the following paragraph, 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.

The Department of Finance monitors compliance with federal arbitrage regulations for all State of Minnesota general obligation bond sales. Because its financial transactions are not recorded on the state's centralized accounting system, the University of Minnesota provides the department with supplemental information on cash balances. However, the information provided by the University does not identify expenditures and cash balances by individual bond issue as required by federal regulations. Therefore, we could not determine whether the state was able to accurately compile data to fully comply with the arbitrage regulations for those bond projects administered by the University of Minnesota.

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 5, 1991.

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, 1991

REPORT SIGNED ON: March 29, 1991

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, CPA	Auditor-In-Charge
John Wicklund, CPA	Staff Auditor
Eric Jacobson	Staff Auditor
Jill Mooren	Staff Auditor

EXIT CONFERENCE

The findings and recommendations in this were discussed with the following staff of the Department of Finance on March 21, 1991:

John Gunyou	Commissioner
Geri Benting	Assistant Commissioner
David Doth	Assistant Commissioner
Peter Sausen	Assistant Commissioner
Roy Muscatello	Statewide Accounting Director
Rosalie Greeman	Financial Reporting Director
Bruce Reddemann	Budget Operations Director
Tom Casey	General Accounting Supervisor

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, 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 115 staff during fiscal year 1990.

The department operates under the direction of a commissioner who is appointed by the Governor. During our audit period, Tom Triplett served as commissioner until December 31, 1989 and Peter Hutchinson replaced him on January 1, 1990. John Gunyou was appointed commissioner effective January 7, 1991.

Department operations are primarily financed through General Fund appropriations. The following schedule shows total departmental operating expenditures, including encumbrances, for fiscal year 1990:

Payroll	$ 5,262,351
Data Processing	1,674,324
Other Administrative Expenditures	1,259,275
Total	$ 8,195,950

Source: Statewide Accounting System Managers Financial Report as of September 1, 1990.

In addition, the department has administrative responsibility for various grant, loan and other programs, with the following financial activity for fiscal year 1990:

Revenue and other receipts -	
Statewide indirect cost recoveries	$11,079,859
Master lease debt repayments and interest	4,826,693
Energy loan repayments and interest	3,374,990
Rural finance and beginning farmer loan repayments and interest	666,386
Revenue bond application deposits	4,379,770
Employee savings bond deductions	4,144,901
Other programs	11,381,914
Total	$39,854,513

Source: Statewide Accounting System Estimated Actual Receipts Report as of September 1, 1990 and Fiscal Year 1990 Comprehensive Annual Financial Report.

Expenditures and other disbursements -	
University of Minnesota grants	$455,875,389
Regional Transit Board grants	25,439,000
Historical Center construction grants	15,679,312
Energy loans	1,474,242
Rural finance and beginning farmer loans	2,260,030
Revenue bond application refunds	3,693,179
Employee savings bond purchases	4,131,915
Master lease debt service	4,913,069
Tort claims	767,083
Other programs	28,148,228
Total	$542,381,447

Source: Statewide Accounting System Managers Financial Report as of September 1, 1990 and Fiscal Year 1990 Comprehensive Annual Financial Report.

The Department of Finance, in conjunction with other state agencies, also provides centralized statewide controls in the following areas:

- statewide accounting system;
- cash receipts and disbursements;
- payroll transaction processing;
- investment transaction accounting and investment income allocation;
- general obligation bonded debt issuance and debt service expenditures; and
- budgets and appropriations.

We include conclusions from our review of these centralized systems in our report on internal control for the state as a whole, which is published in the State of Minnesota's Financial and Compliance Report on Federally Assisted Programs.

II. CURRENT FINDING AND RECOMMENDATIONS

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

State agencies have not been making statewide indirect cost payments in accordance with Department of Finance policies. Total collections for fiscal year 1990 were approximately $11 million. However, only $2.5 million was collected as of March 31, 1990. During fiscal year 1990, only five state agencies paid indirect costs quarterly. Finance policy requires quarterly payments. Approximately 30 other agencies and boards did not reimburse the General Fund on a timely basis.

In addition, some departments have not made indirect cost reimbursements for certain programs. For example, the Department of Human Services has not fully reimbursed the General Fund for indirect costs associated with its programs. Instead, it used available funds for direct program costs. Unpaid statewide and agency indirect costs for three DHS programs totalled $143,430 for fiscal year 1990. In addition, the Department of Transportation (MnDOT) has not paid fiscal 1990 or prior year statewide indirect costs for its federal programs. Because of conflicting federal legislation, DOF exempted the highway construction programs administered by MnDOT from paying indirect costs. However, other federal programs still are obligated to reimburse the General Fund for their assigned share of the costs. MnDOT has not calculated or paid this liability, in part due to delays in approval of its indirect cost plan.

The Department of Finance collects indirect cost reimbursements in accordance with Minn. Stat. Section 16A.127. In prior audit reports to the department, we made various recommendations relating to indirect costs. In March 1985, the department developed Operating Policy and Procedure 06:03:22, which addressed many of our concerns. 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 cost 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".

Even with the revised procedure, the problem has persisted. Agencies have not complied with the policy. The Department of Finance needs to enforce the policy so that the General Fund receives timely reimbursement of indirect costs. Requiring quarterly payments helps ensure that agencies use available funds for indirect cost liabilities, rather than direct program costs. The Department of Finance should follow-up on unpaid billings to verify compliance with quarterly payment 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 receiving federal funds have an approved indirect cost plan from the appropriate federal cognizant agency. The department should monitor billings to agencies with federal funding to ensure they pay at the approved rates for all eligible programs.**

State of Minnesota
Department of Finance

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March 22, 1991

To: Claudia Gudvangen, Audit Manager
Office of the Legislative Auditor

Fr: John Gunyou
Commissioner

Re: Response to Legislative Audit Findings

FINDINGS AND RECOMMENDATIONS

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

RECOMMENDATIONS

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

RESPONSE

The 3rd quarterly indirect cost payment/reimbursements are due on April 26, 1991. The Department of Finance will send out a notice to agencies reminding them of the payment being due and calling their attention to the mandatory quarterly payment of indirect costs. If payments are not received on time, then a listing of agencies not making payment will be distributed to the General Accounting staff, within Finance, for payment monitoring. The payment monitoring process is being transferred to the General Accounting staff. General Accounting will get copies of billings related to indirect costs and be responsible to expedite payments.

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

B. The department should verify that all agencies receiving federal funds have an approved indirect cost plan from the appropriate federal cognizant agency. The department should monitor billings to agencies with federal funding to ensure they pay at the approved rates for all eligible programs.

RESPONSE

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. In the future the Budget Operations section of Finance will prepare a listing of outstanding agencies needing approved indirect cost plans as part of the annual spending plan instructions and process. Executive Budget Officers will contact the Agency head involved. It will be the responsibility of the Executive Budget Officer to assure that the indirect cost plans are prepared.

More staff time will have to be devoted to monitoring billings to assure that agencies are paying at approved rates for all eligible programs and to comply with the other recommendations as stated.

cc: David Doth
Geri Benting
Team Leaders
Executive Budget Officers