AGRICULTURAL UTILIZATION RESEARCH INSTITUTE
FINANCIAL AUDIT
FOR THE PERIOD OCTOBER 1, 1990 - SEPTEMBER 30, 1991

JULY 1992

Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

92-50

Centennial Office Building, Saint Paul, MN 55155 ● 612/296-4708

AGRICULTURAL UTILIZATION RESEARCH INSTITUTE

FINANCIAL AUDIT
OCTOBER 1, 1990 - SEPTEMBER 30, 1991

Public Release Date: July 31, 1992 No. 92-50

OBJECTIVES:

- TEST COMPLIANCE WITH CERTAIN FINANCE-RELATED LEGAL PROVISIONS.
- REVIEW INTERNAL CONTROL STRUCTURE POLICIES AND PROCEDURES IN THE FOLLOWING CATEGORIES: revenue, investments, project expenditures, payroll/personnel, recruiting, and travel.

CONCLUSIONS:

We found one area where the Institute had not complied with finance-related legal provisions:

- The Institute improperly paid per diems to advisory board members.

We found two areas of concern about the control over and reasonableness of certain Agricultural Utilization Research Institute (AURI) fiscal management practices:

- AURI is not providing adequate control over and safeguarding its invested funds.
- AURI granted funds to an employee and created a conflict of interest.

Contact the Financial Audit Division for additional information.
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STATE OF MINNESOTA
OFFICE OF THE LEGISLATIVE AUDITOR
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JAMES R. NOBLES, LEGISLATIVE AUDITOR

Representative Ann Rest, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Gordon Sonstelie, Chair
Agricultural Utilization Research Institute Board of Directors

Members of the Agricultural Utilization Research Institute Board of Directors

Dr. Richard Nelson, Executive Director
Agricultural Utilization Research Institute

Audit Scope

We have conducted a financial related audit of the Agricultural Utilization Research Institute as of and for the period October 1, 1990 through September 30, 1991. Section I provides a brief description of the agency's activities and finances.

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 Agricultural Utilization Research Institute are free of material misstatements.

We performed tests of the Agricultural Utilization Research Institute's transactions to obtain reasonable assurance that the institute had, in all material respects, administered its programs in compliance with applicable laws and regulations. However, our objective was not to provide an opinion on overall compliance with such provisions.

Management Responsibilities

The management of the Agricultural Utilization Research Institute is responsible for establishing and maintaining an internal control structure. This responsibility includes compliance with applicable laws and regulations. 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 Agricultural Utilization Research Institute's accounting system in accordance with applicable 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 significant internal control structure policies and procedures in the following categories:

- revenue,
- investments,
- project expenditures,
- payroll/personnel,
- recruiting, and
- travel.

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. Our review was more limited than would be necessary to express an opinion on the Agricultural Utilization Research Institute's system of internal accounting control taken as a whole. We also considered whether the Agricultural Utilization Research Institute's financial activities were conducted in a reasonable and prudent manner for a public entity. To achieve this objective, we reviewed selected financial policies and practices in effect during the audit period, and as of the time of fieldwork in April 1992.

Reliance on the Work of Other Auditors

The Agricultural Utilization Research Institute contracted with a certified public accounting firm to conduct a financial audit of the institute's financial activity for the period October 1, 1990 through September 30, 1991. The firm issued an unqualified opinion on the institute's financial statements for the period. We relied on the firm's work, where appropriate, in determining the extent of our testing.

Conclusions

The results of our tests indicate that, except for the issue discussed in finding 3, with respect to the items tested, the Agricultural Utilization Research Institute complied, in all material respects, with the provisions referred to in the audit scope paragraphs. With respect to the items not tested, nothing came to our attention that caused us to believe that the Agricultural Utilization Research Institute had not complied, in all material respects, with those provisions.

The issues presented in findings 1 and 2 represent our concerns about the control over and reasonableness of certain Agricultural Utilization Research Institute fiscal management practices.

This report is intended for the information of the Legislative Audit Commission and management of the Agricultural Utilization Research Institute. This restriction is not intended to limit the distribution of this report, which was released as a public document on July 31, 1992.

James R. Nobles
Legislative Auditor

John Asmussen, CPA
Deputy Legislative Auditor

End of Fieldwork: April 17, 1992

Report Signed On: July 27, 1992

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Audit Participation

The following staff from the office of the Legislative Auditor prepared the report:

John Asmussen, CPA	Deputy Legislative Auditor
Claudia Gudvangen, CPA	Audit Manager
Marla Conroy, CPA	Auditor-In-Charge
Judy Cammack, CPA	Staff Auditor

Exit Conference

The findings and recommendations in this report were discussed with the following staff of the Agricultural Utilization Research Institute on July 10, 1992:

Gordon Sonstelie	Chairman of the Board
Richard Nelson	Executive Director
Mary Jo Crystal	Director of Operations

Introduction

Laws of 1987, Chapter 386, Article 2 provided that the Greater Minnesota Corporation, renamed Minnesota Technology, Inc., should establish an agricultural utilization research institute (AURI). AURI was formed to promote the establishment of new products and product uses and the expansion of existing markets for the state's agricultural commodities and products. Laws of 1989, Chapter 350, Article 7, established AURI as a nonprofit corporation. Prior to September 30, 1989, Minnesota Technology, Inc. was responsible for administering the financial transactions of AURI. Since that time AURI has operated as an autonomous entity.

During the audit period, the governing board of the Agricultural Utilization Research Institute (AURI) consisted of 9 directors who served two year terms. In January 1992, AURI's board of directors passed a resolution increasing the number of board members to eleven and the term to four years. AURI also has an advisory board consisting of 26 members representing major farm organizations, commodity councils, agri-business and the Legislature.

The board of directors appoints an executive director, who serves as chief executive officer of the institute. Virgil Smail served as executive director until his resignation in February 1991. At that time, Kamal Motawi served as acting executive director until the appointment of Richard Nelson in August 1991. The AURI state office is located in Crookston on the University of Minnesota campus. There are four regional offices located in Crookston, Waseca, Morris and Marshall.

The mission of AURI includes the identification and creation of new markets and the expansion of existing markets for new or existing commodities. Additionally, AURI is involved in the development of more energy efficient production practices and of new uses for Minnesota agricultural commodities. To accomplish this mission, AURI has designed programs to bring new products to the marketplace. The programs include: Initial Product Assessment, Partnership, and Applied Research Technology Development. The Initial Product Assessment program provides AURI funding for short-term projects that focus on the technical or economic feasibility of products derived from agricultural commodities. The next phase involves the Partnership Program which focuses on product commercialization. The Applied Technology Development Program focuses on in-house research and development.

Agricultural Utilization Research Institute

The following summary shows AURI's financial activity for the year ended September 30, 1991:

Beginning Fund Balance	$1,201,777
Revenue:	
Minnesota Technology, Inc.	$7,313,728
Other	259,705
Total Revenue	$7,573,433
Expenditures:	
Payments to Projects	
Partnerships	$ 297,500
Initial Product Assessment	150,979
Applied Technology Consortium	618,853
Total Project Payments	$1,067,332
Grant Expenses	329,761
Payroll/Personnel	1,102,945
Recruiting	95,315
Staff Travel	99,834
Other	564,534
Total Expenditures	$3,259,721
Ending Fund Balance	$5,515,489

Source: Agricultural Utilization Research Institute audited financial statements for the year ended September 30, 1991 and supporting accounting records.

AURI is governed by Minn. Stat. Chapter 116O, which provides that the institute is not subject to the laws governing a state agency except as otherwise provided. Employees of the institute are not state employees, but are subject to certain provisions of Minn. Stat. Chapter 43A. AURI is not subject to the procedures and controls applicable to state agencies relating to purchasing, expense reimbursements, and other administrative expenditures.

Current Findings and Recommendations

1. AURI is not providing adequate control over and safeguarding its invested funds.

AURI's Board of Directors has not developed a comprehensive investment policy. The Board of Directors should prepare a formal investment policy specifying investment scope and goals, types of authorized investment instruments, risk tolerance, maturity limits, diversification, physical safekeeping and custody, performance reviews, and relationships with banks and investment brokers. Without a formal investment policy, AURI's investment decisions may not coincide with the Board of Director's intentions.

In addition, AURI does not have a formal agreement with the institution that conducts its investment transactions. AURI enlisted the services of an investment brokerage firm. At March 27, 1992, this firm managed AURI's portfolio which had an estimated value of approximately $8,400,000. The portfolio consisted of money market accounts, certificates of deposit, asset and mortgage backed securities and mutual funds. The majority of AURI's funds are in certificates of deposit and mutual funds, totalling $3,800,000 and $4,070,500 respectively. There is an increased risk of mistakes or misunderstandings when terms of an agreement are not formalized. An agreement should include specific language defining the scope of work, types of authorized investment instruments, and fee arrangements.

Finally, AURI does not have its investment balances properly secured. AURI has many deposits which exceed $100,000, which is the maximum value covered by federal depositor insurance. Because AURI is a nonprofit corporation rather than a governmental entity, banks are unable to pledge collateral against funds in excess of federal insurance. There is an increased risk of loss when assets are not properly secured and safeguarded. As of March 31, 1992, AURI held twelve certificates of deposit ranging in value from $150,000 to $500,000. AURI and the investment broker have tried to decrease the risk by dealing with various financial institutions across the country. AURI is working toward acquiring certificates of deposit within federal depositor insurance limits. AURI should continue to work toward securing its investment balances.

Recommendations

- *AURI's Board of Directors should implement an investment policy for the organization.*
- *AURI should formalize the terms and conditions of any agreements with institutions which process its investment transactions.*
- *AURI should structure its investment portfolio to ensure that funds are properly secured.*

2. AURI granted funds to an employee and created a conflict of interest.

During fiscal year 1991, AURI awarded initial project assessment grant funds to an employee of the organization. We believe the arrangement resulted in a conflict of interest for the individual. AURI did not properly manage the project in several respects. AURI did not prepare a formal project agreement with the employee. Furthermore, the employee's regular work responsibilities seem to encompass the project's work plan.

In November 1990, the AURI employee, who was then meat research director, applied for funding under the initial product assessment program. The employee submitted a letter of intent and project proposal. AURI staff and the Board of Director's executive committee reviewed the proposal. The executive committee approved the project for funding. In February 1991, AURI awarded the employee $9,500 in grant funds. The former AURI executive director determined that a standard contract was not necessary since the project director was an employee. The lack of a formal contract presents questions regarding timing of project completion, confidentiality restrictions, repayment provisions, matching and reporting requirements.

In January 1991, AURI approved the employee's request for part-time employment status. The employee's position description as meat scientist includes conducting research and development work on the initial product assessment project. Since the project budget allows for compensation to the employee, there is a risk the employee may receive additional compensation for work considered part of his regular employment. The project budget provided for $3,000 in compensation to the employee. In addition, the budget included $1,000 for an assistant, $2,000 for supplies, and $3,500 for rent. As of April 30, 1992, the employee had been paid $471.94 of the $9,500 award, for reimbursement of project supplies.

AURI does not have a policy to address potential conflicts of interest, specifically relating to its employees. This policy is particularly important for an entity such as AURI which has staff doing ongoing research and which also awards grant funds externally to individuals or organizations for similar activities.

AURI should implement policies and procedures prohibiting grants to employees. The policy should specifically address how conflicts between regular job responsibilities and projects will be resolved. This becomes a greater concern when the applied technology research program grows. Without a formal policy there is an increased risk of potential conflicts of interest in fact and appearance.

Recommendation

- *AURI should develop a conflict of interest policy. The policy should prohibit providing additional compensation to AURI employees through awards of grant project funds.*

3. AURI improperly paid per diems to advisory board members.

During fiscal year 1991, AURI improperly paid advisory board members a total of $576 in per diems. Minn. Stat. Section 116O.09, Subd. 5 states that advisory board members serve without compensation but shall receive their necessary and actual expenses. AURI detected the improper payments made to advisory board members but decided not to seek repayment. In accordance with AURI's by-laws, the Board of Directors are eligible to receive per diem compensation of $48 for their official duties. In addition to compensating the Board of Directors at this rate, AURI staff erroneously paid five advisory board members $48 for each advisory board function attended.

Recommendation

- *AURI should seek repayment of the per diem amounts paid to the advisory board members.*

AURI
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July 15, 1992

James R. Nobles
Office of the Legislative Auditor
Centennial Building
St. Paul, MN 55155

Dear Mr. Nobles:

At our recent closing conference with John Asmussen, Claudia Gudvangen and Marla Conroy, we agreed that the Agriculture Utilization Research Institute would forward a formal response to the findings described in your draft audit report. That response is attached for your consideration. As instructed, the draft has been protected from unauthorized release or exposure.

It is appropriate, we believe, to take this opportunity to commend you and your colleagues. We appreciate the thorough, yet helpful and courteous attitude displayed by all with whom we have worked during this process. In particular, Ms. Conroy and Ms. Cammack demonstrated a superior level of professionalism during their "on-site" visit. AURI views this audit as a service. We believe it helps to preserve the Institute's hard-won integrity and credibility. Your advice is welcome at any time throughout the year.

Mr. Nobles, please accept the accompanying response to your findings and recommendations. While the Legislature's mandate to the Agricultural Utilization Research Institute is unique in many ways, be assured that we intend to operate according to the highest ethical and legal standards.

Sincerely,

Gordon Sonstelie

Gordon Sonstelie
Chairman of the Board

Richard Nelson

Richard Nelson
Executive Director

Mary Jo Crystal

Mary Jo Crystal
Director of Operations

RN:bje

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1. **AURI is not providing adequate control over and safeguarding its invested funds.**

<u>Response</u>:
AURI's Board of Directors has provided informal investment guidance for the organization in the past. A recent decision limiting the ability of financial institutions to pledge collateral against AURI deposits has caused the Institute to restructure its investment portfolio. Therefore, the Board of Directors will review and formalize an investment policy for AURI by November 30, 1992. The investment policy will be written to include provisions for periodic review and revision.

AURI signed an Unincorporated Association Account Form with Edward D. Jones, our primary investment institution. AURI's investment strategy has been presented to Edward D. Jones, and the formal written policies will be amended to our agreement with them.

AURI's investment policy will provide the maximum security on its investment balances. AURI will continue to work toward acquiring certificates of deposit within the federal depositor insurance limits and investing funds in government backed securities.

2. **AURI granted funds to an employee and created a conflict of interest.**

<u>Response</u>:
AURI is currently developing a conflict of interest policy for employees and Board of Directors/Advisory Board members. Employees have not nor will they be provided additional compensation through awards of project funds. Internal research projects will be tracked with the AURI accounting system which would prohibit additional compensation. AURI agrees that "appearances" or "potential" for conflicts can be as troublesome as conflicts in fact. The AURI policy is being developed accordingly.

3. **AURI improperly paid per diems to advisory board members.**

<u>Response</u>:
In May 1991, AURI Board of Directors passed a motion to provide a $48 per day per diem to "Board" members. This motion was incorrectly interpreted to apply to both Board of Directors and Advisory Board. The error was recognized in September 1991 after several Advisory Board members received per diem compensation. AURI admits an error occurred however, does not believe that repayment should be sought. The amount to be returned is outweighed by the cost of recovering the funds. However, AURI management will seek repayment if it is determined that the cost of recovery is less important than other considerations.