

**HIGHER EDUCATION COORDINATING BOARD
FINANCIAL AUDIT
FOR THE THREE YEARS ENDED JUNE 30, 1992**

MAY 1993

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

93-24

HIGHER EDUCATION COORDINATING BOARD

FINANCIAL AUDIT FOR THE THREE YEARS ENDED JUNE 30, 1992

Public Release Date: May 28, 1993

No. 93-24

OBJECTIVES:

- EVALUATE INTERNAL CONTROL STRUCTURE: State grant program disbursements, state grant refunds, state work study disbursements, and contractual services, including Minitex and student loan processing.
- TEST COMPLIANCE WITH CERTAIN FINANCE-RELATED LEGAL PROVISIONS.

CONCLUSIONS:

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

- Cash management of state grant funds needs to be improved.
- Oversight of Minitex funding and finances needs to be improved.
- State grant refund checks need to be deposited promptly

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

- The Higher Education Coordinating Board was not depositing state grant refund receipts daily, as required.

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



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Senator Phil Riveness, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Duane C. Scribner, Chair
Higher Education Coordinating Board

Members of the Higher Education Coordinating Board

Dr. David Powers, Executive Director
Higher Education Coordinating Board

Audit Scope

We have conducted a financial related audit of the Higher Education Coordinating Board as of and for the three years ended June 30, 1992. Our audit was limited to only that portion of the State of Minnesota financial activities attributable to the transactions of the Higher Education Coordinating Board, as discussed in the Introduction. We have also made a study and evaluation of the internal control structure of the Higher Education Coordinating Board in effect at January 1993.

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 Higher Education Coordinating Board are free of material misstatements.

As part of our study and evaluation of the internal control structure, we performed tests of the Higher Education Coordinating Board'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.

Scope Limitation

We did not audit the propriety of expenditures for the Minitex Library Information Network program. The Higher Education Coordinating Board paid \$5,099,169 to the University of Minnesota for administering the program during the audit period. The board also paid the Ohio College Library System \$5,890,000 during the three year period for the Minitex program. As further explained in finding 2, the Higher Education Coordinating Board has been designated by the legislature to be responsible for the coordination and management of the Minitex program, and receives an annual appropriation for that purpose. However, the University of Minnesota administers the program and maintains all detailed documentation to support Minitex expenditures.

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Management Responsibilities

The management of the Higher Education Coordinating Board 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 significant internal control structure policies and procedures into various categories. For all of the internal control structure categories listed below, 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.

- state grant program disbursements,
- state grant refunds,
- state work study disbursements, and
- contractual services, including Minitex and student loan processing.

We also identified two other categories of significant internal control structures, which the Higher Education Coordinating Board accounts for within the Loan Capital Fund: student educational loan fund disbursements, and student educational loan fund principal repayments and interest receipts. The Loan Capital Fund is audited by a private CPA firm annually. The CPA firm is responsible for assessing control risk over the loan funds. As a result, we did not assess control risk on the loan disbursements or repayments. Instead, we limited our work to gaining a general understanding of the control system and performing applicable tests of compliance with finance-related legal provisions.

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Conclusions

Our study and evaluation disclosed the conditions discussed in findings 1 through 3 involving the internal control structure of the Higher Education Coordinating Board. 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.

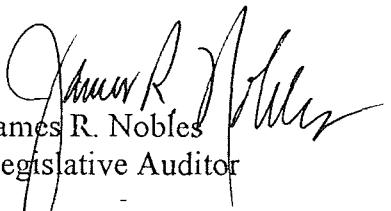
A material weakness is a reportable condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial activities being audited may 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.

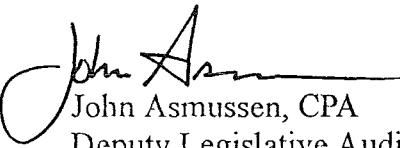
We also noted other matters involving the internal control structure and its operation that we reported to the management of the Higher Education Coordinating Board at the exit conference held on April 13, 1993.

The results of our tests indicate that, except for the issue discussed in finding 3, with respect to the items tested, the Higher Education Coordinating Board 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 Higher Education Coordinating Board 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 Higher Education Coordinating Board. This restriction is not intended to limit the distribution of this report, which was released as a public document on May 28, 1993.

We thank the Higher Education Coordinating Board staff for their cooperation during this audit.


James R. Nobles
Legislative Auditor


John Asmussen, CPA
Deputy Legislative Auditor

End of Fieldwork: March 17, 1993

Report Signed On: May 21, 1993

Higher Education Coordinating Board

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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
Jeanine Leifeld, CPA	Audit Manager
Tony Toscano	Auditor-in-Charge
Joan Haskin, CPA	Auditor
Amy Jorgenson	Auditor
Christina Weiss	Auditor

Exit Conference

The findings and recommendations in this report were discussed with the following officials of the Higher Education Coordinating Board at an exit conference on April 13, 1993:

David Powers	Executive Director
Joe Graba	Deputy Executive Director
Arlon Haupert	Director of Administrative Services
Tim Geraghty	Accountant

Higher Education Coordinating Board

Introduction

The Higher Education Coordinating Board was created by Minn. Stat. Chapter 136A. The board administers several student financial aid programs for Minnesota students. These programs include the state grant program, the state work study program, and the state student educational loan fund program. The board has overall responsibility for these financial aid programs. However, in some cases, individual higher education institutions are also responsible for some aspects of the programs, such as determining eligibility and preventing overpayments to students. Our review of these financial aid programs was limited only to the internal controls which are the responsibility of the Higher Education Coordinating Board. It was not our intention to, nor did we review processes and controls at the campus level.

The Higher Education Coordinating Board also conducts planning for all post-high school education in Minnesota and coordinates the state's post secondary education systems which include the University of Minnesota, the state universities, community colleges, technical colleges, and many privately controlled schools. The board recommends post-secondary education policies to the governor and legislature.

The Higher Education Coordinating Board consists of eight citizen members, one from each congressional district, two at large members, and one student member, all appointed by the governor. Dr. David Powers is the executive director of the board.

The financial activity of the board during the audit period was as follows:

	<u>Fiscal Year Ended June 30</u>		
	<u>1992</u>	<u>1991</u>	<u>1990</u>
Receipts:			
Loan principal repayments	\$ 18,125,572	\$ 15,956,760	\$ 21,016,067
Loan interest	10,046,402	9,817,463	8,158,395
University of Minnesota-Minitex	2,179,000	1,856,000	1,855,000
Other Minitex contracts	588,054	596,116	572,723
Other	<u>3,964,767</u>	<u>5,291,975</u>	<u>3,247,556</u>
Total Receipts	<u>\$ 34,903,795</u>	<u>\$ 33,518,314</u>	<u>\$ 34,849,741</u>

Higher Education Coordinating Board

	<u>Fiscal Year Ended June 30</u>		
	<u>1992</u>	<u>1991</u>	<u>1990</u>
Disbursements:			
State grant program	\$ 80,707,589	\$ 75,447,979	\$ 58,124,968
Loans issued	43,476,981	40,070,969	34,205,412
Contractual services:			
University of Minnesota - Minitex	1,800,917	1,679,272	1,618,980
Ohio Library System - Minitex	2,179,000	1,856,000	1,855,000
EduServ - student loan processing	1,359,645	0	0
Hemar - student loan processing	1,389,842	2,585,981	2,455,931
Other contracts	240,294	928,883	386,766
Work study program	5,729,192	5,395,872	5,244,364
Other disbursements	<u>16,479,690</u>	<u>14,751,749</u>	<u>11,104,911</u>
Total Disbursements	<u>\$153,363,150</u>	<u>\$142,716,705</u>	<u>\$114,996,332</u>

Sources: Statewide Manager's Financial Reports and Estimated/Actual Receipt Reports for fiscal years 1992, 1991, and 1990. Annual financial reports of the HECB loan funds for fiscal years 1992, 1991, and 1990.

Higher Education Coordinating Board

Current Findings and Recommendations

1. Cash management of state grant funds needs to be improved.

The Higher Education Coordinating Board (HECB) does not effectively monitor state grant cash balances at participating schools. During fiscal years 1990 through 1992, HECB disbursed \$253,147,138 in state grant funds to schools. It received \$51,070,004 in refunds back from schools during that period.

HECB has experienced cash flow problems in the State Grant Program requiring legislative action. Minn. Stat. Section 136A.1311 states that "the higher education coordinating board may ask the Commissioner of Finance to lend General Fund money to ease cash flow difficulties." HECB received \$3.4 million in February 1993 and \$1.5 million in March 1993 from the General Fund, based on this statute. In order to receive the loans, HECB must certify to the Department of Finance that refunds expected to be received will be sufficient to repay the loans.

HECB currently uses two different systems to send state grant funds to schools. Under the centralized system, HECB sends a payment roster to the institution, along with either individual student checks or one large grant check. HECB sends the checks as early as three weeks prior to the start of the school term. It provides funds to schools on the assumption that all students will attend full-time. HECB requires the schools to return excess funds within 30 days after the start of the term and charges interest on the refund amount if it is not returned within 45 days of the beginning of the term. Most refunds are generated because students either fail to attend, or are attending less than full-time. HECB needs to more effectively estimate the amount of money needed by schools operating under the centralized disbursement system to meet their state grant obligations. One solution would be to estimate the amount to be disbursed based on prior year awards and refunds. HECB also needs to time their award payments to more closely correspond to the beginning of the school term. We first addressed the problems with cash management over the centralized payment system in a report to HECB dated September 15, 1988.

Under the decentralized system, HECB sends grant funds in a lump sum to schools based on prior year grant disbursements. The schools are then responsible for determining individual award amounts. HECB does not require decentralized schools to report their cash balances on a regular basis. Rather, schools only send in a report when requesting additional grant funds. HECB does not monitor balances on hand for those schools, and only makes them return excess funds after the end of the school year. By more effectively monitoring the cash on hand at the schools, HECB could decrease the need for loans from the Department of Finance and also increase investment potential for the state.

Higher Education Coordinating Board

Recommendation

- *HECB should limit state grant funds disbursed to immediate cash needs.*

2. Oversight of Minitex funding and finances needs to be improved.

The Higher Education Coordinating Board does not maintain effective control over Minitex Library Information Network program expenditures. The mission of the Minitex program is "to enhance the effectiveness and efficiency of participating libraries by expanding their access to . . . state, national, and international information resources." Through the Minitex program, participating libraries may request information, such as books or copies of articles, from the Minitex central office located at the University of Minnesota. Minitex staff then search the resources of other participating libraries for the requested material. HECB received appropriations of \$1,045,000, \$1,083,000 and \$1,208,000 for fiscal years 1990, 1991, and 1992, respectively, for the Minitex program. Since HECB receives the Minitex appropriations, we believe it has a fiduciary responsibility to adequately oversee the program.

HECB needs to improve control over Minitex expenditures in two areas. First, HECB sends its entire annual Minitex appropriation each year to the University of Minnesota, without requiring the University to provide documentation supporting Minitex expenditures. The University has assumed the management of the Minitex program, pursuant to a contract between the University and HECB. However, the legislature has continued to make the Minitex appropriation to HECB, rather than to the University of Minnesota. As a result, we believe that HECB has the responsibility to verify that the appropriation is being properly used, in accordance with the legislature's intent. We do not believe that the University's current quarterly reports to HECB are specific enough to allow HECB to verify that the appropriations are properly used.

Secondly, although HECB is a party to all of the contracts relating to the Minitex program, much of the revenue from these contracts is collected directly by the University of Minnesota. In cases where HECB collects payments, it immediately turns the receipts over to the University. HECB contracts with the Ohio College Library System, the Minnesota Department of Education, the states of North and South Dakota, and numerous individual libraries to participate in the Minitex program. Without a more active role in the fiscal affairs of the Minitex program, HECB unnecessarily exposes itself to liability if the university does not satisfactorily carry out its duties.

Recommendation

- *HECB needs to review its involvement in the Minitex program and determine an appropriate level of fiscal oversight for the program.*

Higher Education Coordinating Board

3. State grant refund checks need to be deposited promptly.

The Minnesota Higher Education Coordinating Board is not making timely deposits of incoming State grant refunds. The board collected approximately \$51 million in grant refunds during fiscal years 1990 to 1992. In ninety-five percent of the sample items we tested, HEBC did not deposit the refund from between two and ten days after receipt. Although HEBC has written policies on prompt depositing, they were not being followed. In addition, Minn. Stat. Section 16A.275 requires daily deposits of receipts exceeding \$250.

Recommendation

- *HECB should ensure that receipts exceeding \$250 are deposited daily, as required by Minn. Stat. Section 16A.275.*

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Finding No. 1

Cash management of state grant funds needs to be improved.

Recommendation:

HECB should limit state grants funds disbursed to immediate cash needs.

HECB Response:

The Higher Education Coordinating Board has been working to refine its state grant distribution system over the past several years, to make it more efficient, while maintaining program integrity, to meet the needs of the participating institutions and our student constituencies and to provide for better cash management of the state's funds. For that reason, we've been working on different payment delivery systems to find one that works the best.

We think that for most institutions, the decentralized delivery system will best fit the students needs, and reduce our necessity to borrow money from the General Fund to ease cash flow difficulties. However, this system is substantially different from the centralized delivery system and requires institutions to both automate their reporting system and to handle the state grant payment process differently. Because of this, each institution has specific problems in both the delivery of state grant payments and the reporting back of the payments to the HEBCB. We work with the institution to resolve their particular problem. Because we are continually bringing additional institutions on to the decentralized delivery system, we expect this to be an ongoing learning period for at least the next two years. In the meantime, we will be continually refining the amount of money disbursed to each institution. This gets more difficult to determine when significant legislative changes that affect the award amount are made.

In regards to reducing the up front payment time that was reiterated in our May 11, 1993 meeting, we feel that as the state's moves to its new accounting system, which we expect will include some form of electronic payments, we can shorten the payment process and reduce the amount of lead time needed for payments. In the meantime, we'll continue to work with individual institutions to refine the expenditure estimates and to reduce the lead time for state grant disbursements.

However, for some institutions, which do not have an automated disbursement and reporting system capability, we'll have to maintain our centralized disbursement system. We expect these to be the smaller institutions and although they may be significant because of their numbers, their amount of state grant payments will be relatively minor. These institutions will all be receiving individual student warrants, so they will only minimally impact cash management.

Finding No. 2

Oversight of MINITEX funding and finances needs to be improved.

Recommendation:

HECB needs to review its involvement in the Minitex program and determine an appropriate level of fiscal oversight for the program.

HECB Response:

Staff acknowledges the auditor's comments. Staff, however, are in constant contact with the MINITEX administration and monitor the process through participation in the decision-making process. The services covered by the contract have been provided as contracted. Staff receives quarterly activities reports from MINITEX and account annually to the HECB by means of an "Annual Report". However, to satisfy the auditor's concerns, the HECB will periodically audit the MINITEX program to assure that the appropriations are being properly used. This will further strain our already inadequate audit capability.

Finding No. 3

State grant refund checks need to be deposited promptly.

Recommendation:

HECB should ensure that receipts exceeding \$250 are deposited daily, as required by Minn. Stat. Section 16A.275.

HECB Response:

As indicated in the Office of Legislative Auditor's explanation, the HECB has written policies on prompt depositing, but they were not being followed. Therefore, the HECB will implement procedures to periodically review the depositing of receipts, to assure that receipts are being deposited promptly. Supervisory staff will at least quarterly review the daily receipts log to assure that deposits are processed in accordance within the one day standard established in statute.