DEPARTMENT OF FINANCE

FINANCIAL AUDIT

FOR THE YEAR ENDED JUNE 30, 1993

APRIL 1994

Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

94-14

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

DEPARTMENT OF FINANCE

FINANCIAL AUDIT
FOR THE YEAR ENDED JUNE 30, 1993

Public Release Date: April 15, 1994 No. 94-14

OBJECTIVES:

- EVALUATE INTERNAL CONTROL STRUCTURE: bond sales, master lease draws and repayments, indirect costs, University of Minnesota grants, and Minnesota Historical Society grants.

- TEST COMPLIANCE WITH CERTAIN FINANCE-RELATED LEGAL PROVISIONS.

CONCLUSIONS:

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

- The Department of Finance needs to improve controls over the collection and monitoring of indirect cost reimbursements.

- The department needs to establish stronger controls when allowing departments to have negative account balances.

We found no departures from finance-related legal provisions. However, we discuss one issue regarding the financial management of state government and how the department has applied a statutory provision:

- The department has expanded its appropriation authority through use of interagency agreements.

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

FINANCIAL AUDIT DIVISION

STATE OF MINNESOTA
OFFICE OF THE LEGISLATIVE AUDITOR
CENTENNIAL BUILDING, ST. PAUL, MN 55155 • 612/296-4708
JAMES R. NOBLES, LEGISLATIVE AUDITOR

Senator Phil Riveness, 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, 1993. 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 outlined below and as further discussed in the Background Section. We have also made a study and evaluation of the internal control structure of the Department of Finance in effect as of June 1993.

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

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

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 and regulations. 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 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 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 in the following categories:

- bond sales,
- master lease draws and repayments,
- statewide indirect costs,
- University of Minnesota grants, and
- Minnesota Historical Society 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 3 involving the internal control structure of the Department of Finance. We consider these conditions to be a 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 do not believe the reportable conditions described above are material weaknesses.

The results of our tests indicated that, 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.

In finding #2, we discuss another matter regarding the financial management of state government and how the Department of Finance has applied a statutory provision.

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 15, 1994.

We thank the Department of Finance's staff for their cooperation during this audit.

James R. Nobles
Legislative Auditor

John Asmussen, CPA
Deputy Legislative Auditor

End of Fieldwork: January 14, 1994

Report Signed On: April 6, 1994

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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	Audit Manager
Cecile Ferkul, CPA	Auditor-in-Charge
Janet Knox, CPA	Staff Auditor
Karen Klein	Staff Auditor
Mary Annala, CPA	Staff Auditor
Geniene Herrlich	Staff Auditor
David Poliseno, CPA	Staff Auditor
Carl Otto, CPA	Staff Auditor
Tanya Morgan	Intern

Exit Conference

We discussed the findings and recommendations in this report with the following officials of the Department of Finance at an exit conference held on March 1, 1994:

Rosalie Greeman	Assistant Commissioner for Accounting Services
Roy Muscatello	Director, Statewide Accounting
Bruce Reddeman	Director, Budget Services

Introduction

The Department of Finance manages the accounting, budgetary and debt management activities of the state. It establishes policies and procedures for state agencies to follow to ensure consistent and reliable financial data and compliance with statutory provisions. The department maintains the state's accounting system and monitors controls to prevent unauthorized transactions.

The Commissioner of Finance, appointed by the Governor, directs the operations of the department. John Gunyou has served as commissioner since January 7, 1991. The department primarily receives General Fund appropriations to finance its operations. For fiscal year 1993, operating expenditures totaled $15,701,816.

Major functions of the Department of Finance during fiscal year 1993 included the following activities:

- The financial reporting unit coordinates preparation of the State's Comprehensive Annual Financial Report, the Comparison of Budget and Actual Revenues, Expenditures and Changes in Fund Balance, and the reports required by the Single Audit Act relating to the receipt and expenditure of federal funds.

- The department, in conjunction with the Departments of Administration and Employee Relations, has undertaken the challenge of replacing the state's computerized accounting, payroll, personnel, procurement and information access systems. The legislature appropriated $1.8 million for project planning in fiscal year 1993 and a total of $15 million for fiscal years 1994 and 1995. The Department of Finance obtained an additional $537,633 in fiscal year 1993 through interagency agreements with seven state agencies. In addition, the department transferred $300,000 from its regular appropriation to the systems project. The department expects the new systems to be operational by July 1, 1995.

- The cash and debt management division coordinates the sale of state general obligation bonds, used mainly to finance state building construction and repair. In fiscal year 1993 the Department of Finance issued bonds exceeding $700 million, including $531 million to refinance outstanding bonds issued at higher interest rates.

- The cash and debt management division also consolidates lease purchases under the master lease program. Master lease purchases in fiscal year 1993 were $12,154,683. Lease payments were $12,614,028. The Department of Administration uses the master lease program mainly to purchase computer equipment and motor pool vehicles.

- The accounting services division processes the payment of appropriated grant funds to the University of Minnesota and the Minnesota Historical Society and other state agencies. General Fund operational grants to the University totaled $431,882,000. In addition, the University received $24,010,481 from bond proceeds for various capital construction projects and $11,172,106 for smaller projects and programs. The Historical Society received $1,085,464 for the construction of history center exhibits, and an additional $12,587,112 for general operations and other interpretive and historic preservation projects.

- The budget services division coordinates preparation of the governor's biennial budget. The budget outlines past spending on a program basis, and proposes the future roles and responsibilities of state government.

- The budget services division also allocates and collects statewide indirect costs. This helps ensure that a program's expenditure base includes all operating costs and, where possible, allows for recovery of those costs from the federal government or through user fees. In fiscal year 1993, agencies reimbursed $9,641,619 to the General Fund.

Findings and Recommendations

1. The Department of Finance needs to improve controls over the collection and monitoring of indirect costs reimbursements.

The department's procedures for monitoring indirect cost reimbursements have resulted in some inconsistencies in the treatment of individual agencies and funding sources. The department annually bills state agencies for certain general government costs of operations, such as use of the statewide accounting system, in accordance with Minn. Stat. Section 16A.127. The Department of Finance has authority to waive the payment of indirect costs for sound financial reasons.

We noted the following problems in our review of indirect costs for fiscal year 1993:

- The Department of Finance has not actively pursued collection of $523,117 in fiscal year 1993 indirect cost reimbursements due from the Department of Human Services (DHS). The amounts in question relate to accounts for operation of the MAXIS computer system. DHS received federal reimbursement for the costs incurred. However, it retained the federal reimbursements for future operations rather than reimbursing the General Fund as required.

- Finance automatically waived indirect cost reimbursements from certain funds without sufficient review or documentation of the basis for the waiver. For example, the department granted automatic waivers to the Environment and Natural Resources Trust Fund and the Minnesota Resources Fund based on an assumption that statutory exemptions existed. These statutes do not, however, contain language that expressly exempts the funds from paying indirect costs. Finance should review the propriety of any automatic waivers on an annual basis.

- The department did not follow up on material differences in the reimbursement amounts for federal programs. Statewide indirect cost reimbursements for federal programs are dependent upon the individual agency indirect cost plans. The amount of indirect costs actually reimbursed by the federal government may differ from the amount Finance allocates to federal programs. For example, in fiscal year 1993, the Department of Health federal fund allocation was $132,652, and it paid $62,000. For material differences between billed and collected amounts, we believe Finance should require agencies to provide supporting documentation

- State agencies did not make quarterly payments to reimburse the General Fund as required by Department of Finance policy. For five of seven billings we tested, agencies did not pay on a quarterly basis. Most of these agencies only made reimbursements once per year. Finance does not monitor or enforce this requirement.

Department of Finance

The Department of Finance has the responsibility to determine, allocate and collect indirect cost reimbursements from the funds that utilize the general government services. Its procedures and processes should result in consistent treatment of state agencies and funding sources.

Recommendations

- *The Department of Finance should require the Department of Human Services to reimburse the General Fund $523,117 for fiscal year 1993 indirect costs.*
- *The Department of Finance should improve its collection and monitoring process for indirect costs by:*
  - -- *documenting and reviewing the reasons for all waivers on an annual basis;*
  - -- *investigating material differences between indirect cost allocations and payments for federal programs;*
  - -- *monitoring and enforcing the requirement for quarterly payment of indirect cost reimbursements.*

2. The Department of Finance has expanded its appropriation authority through use of interagency agreements.

The Department of Finance has obtained additional funding for the statewide systems project through agreements with other state agencies. This practice represents a unique and expanded ability for state agencies to share appropriated funds. The practice offers some advantages. But it also contains certain risks that must be addressed. We are also concerned that the legislature has not been fully apprised of this new practice. The department did not seek statutory authority for these transactions. Instead, it justified the interagency agreement based on its interpretation of a long-standing law that permits joint power agreements between governmental units.

The legislature appropriated $1.8 million to the Department of Finance for systems project development in fiscal year 1993. In addition, the department transferred $300,000 of its regular General Fund appropriation to the systems project. The department also entered into interagency agreements with seven state agencies to provide additional funding totaling $537,633. Table 2-1 identifies the agencies and the amounts provided through interagency agreements.

Table 2-1
Statewide Systems Project
Interagency Agreements
Fiscal Year 1993

Department	Amount
Employee Relations	$227,633
Natural Resources	50,000
Administration	50,000
Transportation	60,000
Revenue	50,000
Human Services	50,000
Public Safety	50,000
Total	$537,633

Source: Statewide Accounting System records as of September 4, 1993.

Department of Finance

The Department of Finance consulted the Office of the Attorney General regarding legal authority for the interagency agreements. The Assistant Attorney General concluded that the Joint Powers Act, Minn. Stat. Section 471.59, authorizes interagency contracts, and further stated:

> ...the Statewide Systems Project appears to be a general administrative project which will have benefits and clear cost savings for agencies. Under the circumstances, absent an express prohibition in an agency's appropriation provisions, an interagency agreement to share costs for the project could be argued to be an appropriate expenditure of an agency's appropriation for general administration.

The Joint Powers Act may provide basic statutory authority for interagency agreements. However, we think the Department of Finance's use of these agreements for the systems project significantly expands the application of the act. There were no direct exchange transactions involved with these agreements. There was no correlation between the amounts provided by the various state agencies and the services or benefits received. Finance developed the agreements based on the amounts that the agencies were willing to donate to the project.

We reviewed other interagency agreements entered into by state agencies in fiscal years 1992 and 1993. For the most part, agencies established those agreements pursuant to specific statutory authority, in addition to the Joint Powers Act. Also, the agreements identified specific services and a clear basis for the payment amount. Table 2-2 identifies some of the larger interagency agreements we reviewed for fiscal year 1993.

Table 2-2
Interagency Agreements
Fiscal Year 1993

Paying Agency	Receiving Agency	Type of Services	Amount Paid	Statutory Authority
Education	State Fire Marshall	Inspections	$260,000	121.1502
Labor & Industry	Health	Inspections	$553,000	182.67
Veterans Affairs	Human Services	Laundry	$235,906	246.57
Corrections	Natural Resources	Park Grooming	$508,314	84.086
TACIP-Note 1	Human Services	Administration	$737,603	237.52

Note 1: Telecommunications Access for Communication-Impaired Persons Board

Source: Fiscal Year 1993 Statewide Accounting System records and interagency agreements.

The Department of Finance intends to enter into additional interagency agreements for future funding of the systems project. We think the department should seek specific legal authority for these agreements.

Recommendation

- *The Department of Finance should discuss legal authority for interagency transfers with the legislature. Possibly, the department should seek specific statutory authority for interagency transfers. It should also consider the need to place any restrictions or conditions on interagency transfers. For example, it may be advisable to correlate the transfer amounts to the value of services exchanged.*

3. Prior Recommendation Partially Implemented: The Department of Finance needs to establish stronger controls when allowing departments to have negative account balances.

In recent years the Department of Finance has allowed agencies to continue operations despite incurring negative account balances resulting from cash flow problems. Typically for these programs, agencies have incurred expenditures that they expected to be reimbursed with federal or other program revenue. A statewide accounting (SWA) system edit prevents an agency from recording expenditures unless it has sufficient resources available in the source account. Once Finance removes the SWA edit that prevents an account from going negative, the department limits its ability to monitor or control the account's activities. In our prior audit, we recommended that the Department of Finance improve controls over the monitoring of these negative accounts. Finance did make improvements in this area. It now reviews monthly reports and contacts agencies when authorized limits are exceeded or repayments are delinquent.

Despite improvements, this area remains risky. Without the system control, there is a risk that departments will process expenditure transactions exceeding the agreed upon limit or use the account for unintended purposes. The Department of Finance cannot prevent the processing of those transactions and can only detect them once they have occurred.

For example, during fiscal year 1993, the Department of Jobs and Training inappropriately used its ability to operate in negative state to obtain an unauthorized interest free loan of $3.1 million. The department paid that amount for remodeling costs from an account that Finance authorized to go negative. Finance had removed the SWA edit for federal cash flow reasons. However, the remodeling costs are not a part of the federal programs and are not eligible for federal reimbursement. The department intends to pay for the costs from revenue collected for penalty and interest assessments. As of January 1994, the Department of Jobs and Training had repaid $1.7 million. The department estimates that it will take until fiscal year 1995 to repay the remaining $1.4 million.

The Department of Finance loses significant control over departmental activities by removing the spending edit. Therefore, it should require that departments provide detailed information about cash flow requirements, including timing and the source of funds available for repayment. The state agencies should provide Finance with a schedule of anticipated receipts and periodic reports on the status of the account, including prompt notification of an inability to make timely repayments.

Department of Finance

New legislation in 1993 has given the Department of Finance an alternative to the negative balance authorizations. Minn. Stat. Section 16A.129, Subd. 3, now authorizes loans from the General Fund to other funds for cash flow purposes. If Finance would use this authority and provide a direct loan to other funds, it could retain the spending edit in the statewide accounting system, thereby limiting the amount of the loan to an authorized amount. Finance needs to develop polices and procedures to define the situations when departments could obtain these loans, how departments would apply for them, and the conditions for repayment.

Recommendations

- *The Department of Finance should require more extensive analysis and periodic reporting by departments requesting and receiving authorization to have negative account balances.*

- *The Department of Finance should develop policies and procedures to implement the provisions of Minn. Stat. Section 16A.129, Subd. 3, allowing the General Fund to make loans to other funds for cash flow purposes.*

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State of Minnesota
Department of Finance

400 Centennial Building
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(612) 296-5900

April 1, 1994

To: John Asmussen
Deputy Legislative Auditor
Office of Legislative Auditor

Fr: for John Gunyou Rosalie Greeman
Commissioner

Re: Response to Legislative Audit Findings

Thank you for the opportunity to respond to your audit recommendations. As you may know, we had an employee group do a preliminary re-engineering review of the department. That, along with the improvements that we have made in recent years - especially in the indirect cost area and the opportunity provided by the statewide systems project - have enabled progress in correcting existing problems and finding new ways to meet our responsibilities. We appreciate your suggestions.

<u>Current Findings and Recommendations</u>

1. **The Department of Finance needs to improve controls over the collection and monitoring of indirect cost reimbursements.**

   - **The Department of Finance should require the Department of Human Services to reimburse the General Fund $523,117 for fiscal year 1993 indirect costs.**

   Response: The Department of Finance is actively pursing the reimbursement of indirect costs from the Department of Human Services in the amount of $523,117 for FY 1993.

   - **The Department of Finance should improve its collection and monitoring process for indirect costs by:**

   -- documenting and reviewing the reasons for all waivers on an annual basis;

   Response: Minnesota Statute 16A.127, subd. 3, grants the Commissioner of Finance the authority to waive indirect cost reimbursement for reason of sound financial management. This authority is used to grant waivers to funds that represent a split of general fund revenues to various funds, as well as funds held in trust such as inmate funds.

The Department of Finance has presented language to the 1994 legislature to clarify waivers set in law. It is our position that the schedule of state funds is relatively stable, and annual review and documentation of waived funds would add little value to the process. However, we will maintain a log of all automatic waivers and update it as law changes are made.

-- investigating material differences between indirect cost allocations and payments for federal programs;

Response: Our current procedures recognize the principle that federal programs paying indirect cost may vary from year to year. The annual indirect cost bill is based on calculated historical statistics and projected budgets. The department's procedure of charging an indirect cost rate rather than an absolute amount ensures that all federal programs pay indirect costs while program funding is available. However, on an annual basis, the level of funding for federal programs may vary as may conditions and limitations on indirect cost reimbursement. As a result, this is a normal occurrence. The actual billed (allocated) amount and the indirect cost reimbursement will be different.

The department will establish a threshold for material difference, and will establish procedures to investigate material differences between the amounts allocated and the amounts actually received. This will be done annually and appropriate documentation will be maintained explaining material differences between billed and collected amounts.

-- monitoring and enforcing the requirement for quarterly payments of indirect cost reimbursements.

Response: The Department of Finance will increase our efforts to monitor and enforce quarterly indirect cost reimbursements to the general fund. This is in line with our current accounts receivable and collections efforts.

2. The Department of Finance has expanded its appropriation authority through the use of interagency agreements.

- **The Department of Finance should discuss legal authority for interagency transfers with the legislature. Possibly, the department should seek specific statutory authority for interagency transfers. It should also consider the need to place any restrictions or conditions on interagency transfers. For example, it may be advisable to correlate the transfer amount to value of services exchanged.**

Response: The practice of transferring funding between agencies for joint cooperative projects that benefit a grouping of agencies is not a new or unique practice. It has been common practice in cooperative multi-agency projects to contribute funding either by transfer or direct interagency payment. Examples range from joint-sponsored seminars, to systems development, to other shared operating expenses.

Specific examples of voluntary project contributions have occurred within the Department of Finance. In 1988 and 1989, the department obtained additional funds from other state agencies for development of the on-line employee history project. In FY 1988, agencies contributed to biennial budget system enhancement efforts, which also included a voluntary contribution from the Legislative Commission on Planning and Fiscal Policy.

As noted in the Legislative Auditor's comments, specific authority exists as provided for in interagency agreements in the Joint Powers Act, Minn. Stat. Section 471.59, which has been confirmed by an Attorney General's opinion relating to the Statewide Systems Project.

The department does not believe that additional action to seek specific statutory authority for interagency transfers is necessary or desirable. Further, the department does not believe it necessary, or advisable, to place any additional restrictions or conditions on interagency transfers. Such action would be contrary to recent actions of the legislature to increase agencies' management flexibility. Changes enacted in the 1993 session to eliminate complement control, increase agencies' ability to transfer funds between programs and carry forward unused operating funds from the first to the second year of the biennium are representative of efforts to increase agencies' flexibility to manage budgets within appropriated limits.

In many cases, the choice of multi-agency cooperative ventures represents a more logical, cost-effective approach to certain activities than would individual agency investments. This represents an individual agency management choice and perception of value received. This has been particularly true in the technology area. Existing statute provides maximum flexibility in managing multi-agency projects.

The department concurs with the need to inform legislators of interagency project transfers. Biennial budget instructions specifically provide for budgeting interagency transfers. New interagency operating agreements made during the biennium should be subject to the same reporting requirements as transfers between programs.

The department has informed legislative committees of the practice of interagency transfers associated with the Statewide Systems Project. Additionally, in order to fully identify the direct costs of the project, we have required that all expenditures be made from SSP accounts. Because the project has also included involvement of staff donated from other operating agencies, we have also requested that SSP maintain a record of the value of these resources. We intend to include loaned staff costs as part of total project costs in our reporting to the legislature.

3. **Prior Recommendation Partially Implemented: The Department of Finance needs to establish stronger controls when allowing departments to have negative account balances.**

- **The Department of Finance should require more extensive analysis and periodic reporting by departments requesting and receiving authorization to have negative account balances.**

Response: We feel that the current process of monthly analysis of all accounts with negative balances during the month should highlight problems before they reach crisis stage. When the analysis shows that the account has exceeded its authorized negative balance, or where the balance is not being restored in a timely manner, we follow up with the agency. Where federal programs are part of the federal cash management act, negative balances will occur because of the limitations on drawing down federal funds. In addition, the Department of Finance will require a monthly report from the Department of Jobs and Training beginning in March of 1994.

Note: The new accounting system will provide a better indicator of when an account is actually negative, i.e., when the warrant for the expenditures have been redeemed and the cash is withdrawn from the treasury. Negative balances **can** be misleading, because the current system and process records the reduction of cash when the warrant is mailed (before the federal funds can be requested).

- **The Department of Finance should develop policies and procedures to implement the provisions of Minn. Stat. Section 16A.129, Subd.3, allowing the General Fund to make loans to other funds for cash flow purposes.**

Response: When the Department of Finance requested legislation that resulted in the statute cited, we didn't anticipate the language which resulted. The original language was drafted with the intent to expand the current practice of removal of negative edits from federal accounts to other funds. We will seek legislation in the 1995 session to clarify the current practice of permitting negative balances.

cc:	Laura M. King	Roy Muscatello
	Rosalie Greeman	Team Leaders
	Claudia Gudvangen	Executive Budget Officers