

MINNESOTA STATE ARTS BOARD

FINANCIAL AUDIT

FOR THE THREE YEARS ENDED JUNE 30, 1993

JULY 1994

Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

94-37

MINNESOTA STATE ARTS BOARD
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Public Release Date: July 29, 1994

No. 94-37

OBJECTIVES:

- **EVALUATE INTERNAL CONTROL STRUCTURE:** Grants and aids, administrative expenses, federal grant revenue and other revenue.
- **TEST COMPLIANCE WITH CERTAIN FINANCE-RELATED LEGAL PROVISIONS.**

CONCLUSIONS:

We found one area where the internal control structure needed improvement:

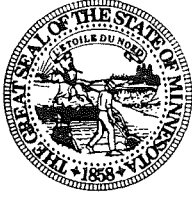
- The board made errors in paying some invoices, did not properly document some payments, and did not adequately segregate purchasing functions.

We found four areas of noncompliance with finance-related legal provisions:

- The board incurred expenses to influence legislative action.
- The board's relationship with the Minnesota Arts Communicators, a professional organization, is unclear. It is unclear whether Minnesota Arts Communicators is a separate organization or a board project.
- The board incorrectly deposits mail receipts, refunds, and reimbursements to its gift account.
- **PRIOR FINDING NOT RESOLVED:** The board maintains excessive cash balances in its federal accounts.

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

FINANCIAL AUDIT DIVISION



STATE OF MINNESOTA
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JAMES R. NOBLES, LEGISLATIVE AUDITOR

Senator Phil Riveness, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Ms. Elizabeth C. Whitbeck, Chair
Minnesota State Arts Board

Members of the Minnesota State Arts Board

Dr. Sam Grabarski, Executive Director
Minnesota State Arts Board

Audit Scope

We have completed a financial related audit of the Minnesota State Arts Board for the period covering the three years ended June 30, 1993 as outlined below, and as further discussed in the Introduction. We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we consider the internal control structure in order to plan our audit, and that we perform tests of the department's compliance with certain material provisions of laws, regulations, contracts and grants. However, our objective was not to provide an opinion on the internal control structure or on overall compliance with finance-related legal provisions.

Internal Control Structure

For purposes of this report, we have classified the significant internal control structure policies and procedures into the following categories:

- Grants and aids;
- Administrative expenses;
- Federal grant revenue; and
- Other revenue.

For 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.

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Management Responsibilities

Management of the Minnesota State Arts Board is responsible for establishing and maintaining the 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 internal control 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.

Conclusions

Our audit disclosed the conditions discussed in finding 1 involving the internal control structure of the Minnesota State Arts 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. Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable

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conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. We believe that none of the reportable conditions are material weaknesses.

The results of our tests of compliance indicate that, except for the issues discussed in findings 2 through 5, with respect to the items tested, the Minnesota State Arts Board complied, in all material respects, with the provisions referred to in the audit scope paragraphs. With respect to the items not tested, nothing else came to our attention that caused us to believe that the Minnesota State Arts Board had not complied, in all material respects, with those provisions.

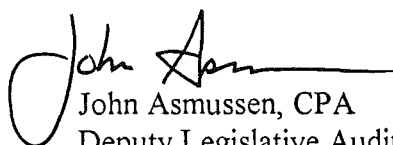
We also noted other matters involving compliance with laws and regulations that we reported to the management of the Minnesota State Arts Board at the exit conference held on June 8, 1994.

This report is intended for the information of the Legislative Audit Commission and management of the Minnesota State Arts Board. This restriction is not intended to limit the distribution of this report, which was released as a public document on July 29, 1994.

We thank the Minnesota State Arts Board staff for their cooperation during this audit.



James R. Nobles
Legislative Auditor



John Asmussen, CPA
Deputy Legislative Auditor

End Of Fieldwork: May 6, 1994

Report Signed On: July 25, 1994

Minnesota State Arts 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
Renee Redmer, LPA	Audit Manager
Jean Mellett, CPA	Auditor-in-Charge
Jenny Lee	Auditor

Exit Conference

The findings and recommendations in this report were discussed with the following staff of the Minnesota Arts Board on June 8, 1994:

Sam Grabarski, Ph.D	Executive Director
Robert Booker	Assistant Director
Rick Jeanette	Accounting Director
Natalie Madgy	Grants Officer
Marjorie Casey	Program Associate

Minnesota State Arts Board

Introduction

The Minnesota State Arts Board is a state agency dedicated to making the arts available to all citizens in Minnesota. It was first established as the State Arts Society by the Minnesota legislature in 1903. The Society sponsored exhibitions and actively promoted the folk arts and crafts until 1947 when the legislature withdrew its appropriation.

In 1956 the Society was revived and an eleven member board was created to direct its activities. Over the years the Society was involved in sponsoring traveling exhibitions and competitions, designing and erecting monuments, advising state planners on matters of building construction, and offering scholarships to students and artists. In 1965 the legislature dissolved the Arts Society and created the Minnesota State Arts Council in its place. In 1976 the enabling statute of the Arts Council was amended and it was officially renamed the Minnesota State Arts Board.

The board is governed by eleven Minnesota citizens who are appointed by the Governor to serve four year terms. The board makes policy decisions regarding programming and makes final funding decisions regarding grants assistance. The board appointed Dr. Sam Grabarski as executive director to oversee and operate the Minnesota State Arts Board administrative office.

The board offers a series of grants, programs, and services for individual artists, arts organizations, and schools throughout the state. The board's primary sources of funds are state appropriations and grants from the National Endowment for the Arts. The board administered grants for the McKnight Foundation through fiscal year 1991. McKnight Foundation funds totaled \$750,000 annually. In fiscal year 1993, the board had revenues, appropriations, and expenditures as shown in Table 1-1.

Table 1-1
Revenues, Appropriations and Expenditures
Fiscal Year 1993

<u>Revenue and Appropriations:</u>	
Federal grants	\$ 836,800
Other revenue	92,603
Interest income	<u>8,616</u>
Total revenue	\$938,019
State appropriations--1993	\$4,018,000
Carryover from 1992	<u>205,088</u>
Total Revenue and Appropriations	<u>\$5,161,107</u>
<u>Expenditures:</u>	
Grants and aids	\$4,257,937
Administrative expenses	238,075
Personnel services	<u>561,157</u>
Total expenditures	<u>\$5,057,169</u>

Source: Statewide Accounting System Reports as of September 8, 1993.

Current Findings and Recommendations

- 1. The board made errors in paying some invoices, did not properly document some payments, and did not adequately segregate certain purchasing functions.**

The Minnesota State Arts Board (board) has paid duplicate invoices, made payments to the wrong vendor, and has not properly documented some payments. Duties are not adequately segregated when the accounting director initiates certain computer equipment and software purchases. The board needs to improve controls over disbursements to ensure that errors or irregularities do not occur.

The board has paid duplicate invoices and made payments to the wrong vendor as follows:

- The board erroneously paid \$2,727 to Graceland Graphics, a state vendor, in July 1992. Graceland Graphics did not acknowledge that it had been overpaid until we contacted the company in May 1994. Graceland Graphics refunded the board the overpayment within a few days of our inquiry. The board made a second \$2,727 payment to the correct vendor in October 1992, three months after it erroneously paid Graceland Graphics. Board staff did not detect that it had paid the same invoice twice or that the board had originally paid the wrong vendor.
- The board paid a \$225 Duluth Radisson invoice twice in July 1992. The board paid the invoice as part of a combined billing, then separately paid the invoice. Neither the board nor the Duluth Radisson detected the overpayment. The board requested a refund from the Radisson in May 1994 after we notified it of the overpayment.
- The board erroneously paid \$59 to the Duluth Radisson for a St. Paul Radisson invoice. Board staff said that they discovered the error and requested the Duluth Radisson to transfer the payment to St. Paul. However, as of May 18, 1994, St. Paul Radisson staff said that they had not received the money.

The board needs to strengthen controls to ensure that payments are properly made and made to the correct vendor. Staff should review procedures for verifying the accuracy of payments. Department of Finance Operating Policy and Procedure 06:05:03 requires payment input operators to verify that the vendor name and address on the statewide accounting payment screen matches the vendor name and address on the invoice. Also, staff responsible for purchases periodically should review vendor payments to verify that payments are accurate.

Board documentation for some payments is inadequate. The board sometimes does not have vendor invoices to document payments. Board staff code payments on department purchase orders or blank sheets of paper when invoices are missing. For example:

Minnesota State Arts Board

- The board documented a \$661 payment to American Express with a purchase order that described the payment as an "annual meeting in Duluth, dinner at the Pickwick for board, staff, and guests". Board staff did not have either the Pickwick bill or the American Express charge receipt.
- The board coded a \$500 payment to the Minneapolis Institute of Arts on a blank sheet of paper. The coding block description was "MCA/MSAB Velveteen Rabbit". The board did not have an invoice or other documentation to support the payment.
- The board paid a \$516 personal expense report claim for a board reception. The board did not have a receipt to document the claim.
- The board documented two workshop refunds with a telephone message slip and a coded sheet of paper.

The board should properly support its disbursements with invoices or receipts detailing the specific purchases. This documentation is necessary to ensure the propriety of payments.

The board does not have an adequate segregation of duties when purchases are initiated by the accounting director. Duties are inadequately segregated when the same person orders, receives, and pays for goods. For example, the accounting director orders computer equipment and software without an independent review of these items. The board needs to develop mitigating controls for occasions when the accounting director purchases goods and services. Another employee should review and approve these purchases.

Recommendations

- *The board should strengthen disbursement controls as follows:*
 - *Verify vendor names and addresses when inputting payments;*
 - *Review vendor payments for proper purchases; and*
 - *Adequately document expenditures.*
- *The board should develop mitigating controls when separation of duties is inadequate.*

2. The board incurred expenses to influence legislative action.

The board paid expenses for registered lobbyists and incurred costs to influence legislation. Minn. Stat. Section 15.057 prohibits state departments from paying the salary or expenses of a publicity representative. State law does not address the propriety of other costs intended to influence legislative action. However, we question the board's decision to incur the following costs:

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- The board cosponsored "legislative events" with the Minnesota Citizens for the Arts. According to the Ethical Practices Board, Minnesota Citizens for the Arts (MCA) is a lobbyist principal that spends from \$50,001 to \$150,000 annually "to influence legislative action, administrative action, and the official action of metropolitan governmental units". Total costs for the fiscal year 1993 jointly sponsored legislative event were \$7,600. The board contributed \$3,000 to pay for a musical performance at the Minnesota Opera.
- Guests at board events during the fiscal year 1993 leadership conference included two lobbyists. Minnesota Citizens for the Arts lobbyists attended special board events, including dinner at the Pickwick and a play at the Duluth playhouse.
- The board paid expenses totaling \$695 for eight people who testified at legislative budget hearings. The eight people are not state employees. The executive director said the board did not want arts advocates from rural areas to suffer a hardship due to travel costs.

Recommendation

- *The board should not pay lobbyist expenses or costs to influence legislative actions.*

3. The board's relationship with a professional association is unclear.

The board needs to clarify the status of Minnesota Arts Communicators, a professional association headquartered at the Minnesota State Arts Board. It is unclear whether Minnesota Arts Communicators is a separate organization or a board project.

Minnesota Arts Communicators was started by a board employee at the direction of the board's executive director. Minnesota Arts Communicators is an association for people who manage communications for arts and cultural organizations. The purpose of Minnesota Arts Communicators is to facilitate contact with colleagues, share information and resources, and to provide a forum for discussing key issues.

The board provides some services and financial support to Minnesota Arts Communicators. The board pays postage costs for Minnesota Arts Communicators mailings. The board permits Minnesota Arts Communicators to use its mailing address. Members send dues to the board's address. A board employee records Minnesota Arts Communicators dues in a receipts log. However, Minnesota Arts Communicators has a separate fiscal agent. Board staff forward Minnesota Arts Communicators dues to Intermedia Arts, the association's fiscal agent. Intermedia Arts pays most of Minnesota Arts Communicators' expenses.

The board needs to clarify the status of Minnesota Arts Communicators. If Minnesota Arts Communicators is a separate and distinct entity, the board should enter into a contract in order to provide personnel services and postage to the association. If Minnesota Arts Communicators is simply a vehicle for accomplishing board projects, the association should discontinue its fiscal relationship with Intermedia Arts. The board should account for project funds on the statewide accounting system if this is a state activity.

Minnesota State Arts Board

Recommendation

- *The board should clarify the status of Minnesota Arts Communicators.*

4. The board incorrectly deposits mail list receipts, refunds, and reimbursements to its gift account.

The board deposited fiscal year 1993 mail list and workshop receipts, grant refunds, and travel reimbursements in its gift account. The board does not have legislative authority to deposit these funds in the gift account. The board also earned interest on these funds without the proper statutory authority. In addition, the board used refunds and reimbursements of state appropriated expenditures rather than canceling these funds to the General Fund. The board's General Fund account also does not show mail list and workshop receipts, as required by Minn. Stat. Section 16A.72.

The board does not have authority to deposit mail list and workshop receipts in its gift account. It does have authority to deposit these funds in the General Fund and use for board activities. However, it does not have authority to earn and use interest on these funds. In fiscal year 1993, the board deposited mail list receipts totaling \$1,150 and workshop fees totaling \$2,940 in its gift account. The board deposited these receipts in the gift account to earn interest for its use. Minn. Stat. Section 16A.72 requires agencies to deposit "all income, including fees or receipts of any nature" to the General Fund, unless otherwise provided by law. The board may use mail list and workshop receipts for board activities, but not the interest. Interest earnings are dedicated to the General Fund for other uses. Minn. Stat. Section 129D.04, subd 6, annually appropriates "receipts from the sale of publications, mailing lists, recordings, or media projects, and fees from seminars or workshops" to the board.

The board does not have authority to use other state or federal refunds and reimbursements for purposes other than those specified in appropriation laws or federal grant agreements. It also does not have authority to earn interest on these funds. In addition, the board must use funds within a stated time period. If the board does not use funds within the appropriate time period, the board must either cancel funds to the General Fund or return funds to the federal government. Because the board may keep gift account funds, the board has increased its available funds without obtaining the appropriate legislative approval. During fiscal year 1993, the board deposited grant refunds totaling \$28,924 and reimbursements totaling \$1,238 in its gift account. The board should have deposited refunds and reimbursements into the state or federal accounts that originally paid the expenditures.

Recommendations

- *The board should deposit mail list and workshop receipts to noninterest bearing accounts in the General Fund.*
- *The board should deposit grant refunds and reimbursements to the state or federal accounts that originally paid the expenditures.*
- *The board should transfer improperly deposited receipts to the correct state and federal accounts. The board should cancel receipts to the General Fund and return funds to the federal government, if appropriate.*

Minnesota State Arts Board

5. **PRIOR FINDING NOT RESOLVED: The board maintains excessive cash balances in its federal accounts.**

The board maintains higher cash balances than it needs for current operations in its federal program accounts. The board draws federal cash without accurately estimating the amount needed for current disbursements. The board needs to time funds requested with its immediate cash requirements. The board should draw funds more frequently to meet its cash disbursements.

The following analysis of month-end federal cash balances for fiscal year 1993 shows that cash draws exceeded amounts necessary to meet current needs.

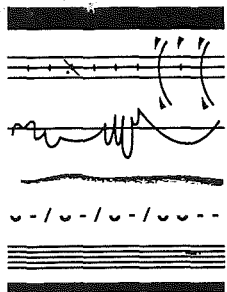
- National Endowment for the Arts (NEA) Block Grant (CFDA# 45.007) month-end balances ranged from \$121,192 to \$180,004 for the period covering December 31, 1992 to March 31, 1993
- Folk Arts program (CFDA# 45.007) month-end balances ranged from \$15,624 to \$50,000 for the period of May 31, to August 31, 1993.
- Locals program (CFDA# 45.007) month-end balances ranged from \$10,216 to \$18,716 for the period covering September 30, 1992 to January 31, 1993.
- NEA Expansion Arts program (CFDA# 45.010) month-end balances ranged from \$10,000 to \$92,500 for the period of July 31, 1992 to May 31, 1993.

The National Endowment for the Arts funds finance both operating expenditures and subgrantee awards. The board obtains funds to operate federal programs by mailing requests for advance or reimbursement to the NEA. The NEA then mails federal warrants to the board. Board staff stated that it takes at least 12 to 15 days to receive money from the National Endowment for the Arts. Even with these time delays, we believe that the board can more accurately predict cash requests. The board could use the amounts of the subgrantee awards to calculate the future cash requirements. Subgrantees typically have 45 days to request funds after receipt of the grant award. The board could request funds for subgrants made to have funds available within a few days of this time frame.

Federal guidelines state that cash advances to a recipient organization shall be limited to the minimum amounts needed and shall be as close as possible to the actual cash disbursements.

Recommendation

- *The board should limit federal cash on hand to the minimum amount needed for current operations.*



MINNESOTA
STATE ARTS BOARD

July 22, 1994

James R. Nobles
Legislative Auditor
State of Minnesota
Office of the Legislative Auditor
Centennial Building
Saint Paul, Minnesota 55155

Dear Mr. Nobles:

This letter serves as the Arts Board management's response to findings contained in your financial audit of the Minnesota State Arts Board for the three years ended June 30, 1993.

Concerning Finding One, which cites seven transactions which either contained errors or should have contained more documentation, we accept all recommendations. According to our financial officer, the period of time covered by the audit encompassed 9,908 transactions, which shows that our systems are fundamentally sound. However, we must strive for complete accuracy, and accept all recommendations, with full compliance by our financial officer, Rick Jeanette, within thirty days.

Concerning Finding Two, which cites three instances where costs may have been expended to influence legislation, we agree in principle with the recommendation. The State Arts Board does not pay a lobbyist, and Minnesota Citizens for the Arts (MCA) is an independent organization serving the broad arts community and completely outside of our agency. We agree that instance one, where the Arts Board acted on established policy to pay performance fees for professional artists, could be misconstrued, and will cease such transactions, effective immediately.

Instance two, where regional arts leaders were honored at special events, did include two MCA representatives as guests. The Arts Board makes no payments to Minnesota Citizens for the Arts, does not supervise any of its employees, and does not authorize MCA to lobby legislators on our behalf. To

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avoid confusion, however, we will ask MCA representatives to reimburse the Arts Board for attendance at any special honorary functions, effective immediately.

Regarding instance three, where constituents were reimbursed for travel costs to testify during the Arts Board's scheduled biennial hearings, the Arts Board disagrees with this citation. Believing that state law does not prohibit such expenses, the Arts Board purposefully invites non-Metro constituents at the request of Minnesota Legislators serving on our appropriations subcommittees. These guest presenters report on the impact of past arts funding, future needs, and the perspectives of eleven regional arts councils for which the Arts Board serves as fiscal agent for the State of Minnesota. Without financial assistance (which we limit to state rates for state employees) few non-Metro constituents could participate, and the Metropolitan Twin Cities perspective would dominate the hearings. Totalling only \$695 during the audit period, we believe that such costs are appropriate expenditures to ensure geographic balance in biennial budget presentations. Because we agree in principle with the point of this citation, we will continue our past practice to otherwise decline all travel assistance to arts constituents to testify about all other arts-related legislation.

Concerning Finding Three, the Arts Board's relationship with Minnesota Arts Communicators, we accept the recommendation. To improve the status of media coverage of the arts, the Arts Board acted to create the Communicators organization as a project, and temporarily allowed the new association to use the Arts Board as a center for mailings and meetings. Now, in accordance with plan, the group is capable of self-direction. We will instruct our public information officer, Marjorie Casey, to act on this recommendation within thirty days.

Concerning Finding Four, that the Arts Board makes incorrect deposits in our gift account, we accept the recommendations. Because the Arts Board's charter (Statutes 129D.04) allows the Board to earn interest and to retain selected service fees, the cited examples were thought to be appropriate deposits in the past. The recommendations will guide future deposits in our gift account. We will instruct our financial officer, Rick Jeanette, to act immediately on this recommendation.

Concerning Finding Five, our cash balances in federal accounts, we accept the recommendation. All 56 state and territorial arts agencies have continued to ask the National Endowment for the Arts to return to their prior practice of paying federal grants through wire transfer. In the past, it was quite practical to limit cash on hand to the minimum amount needed to pay agency grants to constituents. Current federal practices require the Arts Board to place federal rules ahead of the cash flow needs of

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the Minnesota arts community. However, we must strive to comply with federal requirements, and even though our federal funding increased by 39.4-percent during the audit period, we accept the recommendation. We will instruct our financial officer, Rick Jeanette, to act upon this recommendation immediately.

We note that, with the exception of the above findings, that the Minnesota State Arts Board complied, in all material respects, with the provisions of the audit. We note further that nothing else came to the attention of your staff to cause doubt that the Minnesota State Arts Board had not complied with rules and laws associated with items not tested during the audit.

Thank you for your thorough review of our agency, and for your recommendations.

Sincerely,

A handwritten signature in cursive script, reading "Sam W. Grabarski". The signature is written in black ink and is positioned below the word "Sincerely,".

Dr. Sam W. Grabarski
Executive Director

SWG/gb

cc: Robert Booker, Assistant Director
Richard Jeanette, Accounting Officer
Marjorie Casey, Communications Director
Minnesota State Arts Board Members