METROPOLITAN SPORTS FACILITIES COMMISSION*

FINANCIAL AUDIT

FOR THE YEAR ENDED DECEMBER 31, 1993

*** The Metropolitan Sports Facilities Commission is a component unit of the Metropolitan Council**

SEPTEMBER 1994

Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

94-49

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

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Public Release Date: September 14, 1994 No. 94-49

On May 16, 1994, we published the commission's audited financial statements (see Report # 94-23). However, we delayed completion of the reports on the commission's internal control structure and finance-related legal compliance until now. From December 31, 1993 to April 29, 1994, the commission experienced a significant decline in the market value of its investments (see footnote 9 to the audited financial statements). As a result it initiated a comprehensive study of its investment policies and practices. We chose to withhold these reports, pending the outcome of that study.

OBJECTIVES:

- ASSESS INTERNAL CONTROL STRUCTURE: Cash and investments, operating revenue, operating expenses, payroll, and fixed assets.
- TEST COMPLIANCE WITH CERTAIN FINANCE-RELATED LEGAL PROVISIONS.

CONCLUSIONS:

We found that the internal control structure provided commission management with reasonable assurance regarding the safeguarding of assets and the proper execution and recording of transactions.

We found four issues that affected compliance with finance-related legal provisions:

- The commission did not comply with the requirements of Minn. Stat. Section 118.01, subd. 2 for having sufficient collateral for its bank deposits on 37 days during the years.
- The commission improperly allowed a former employee to accrue sick and holiday pay, resulting in an overpayment of $1,288 to the employee.
- The commission did not publish its audited financial statements by April 30, 1994, as required by the covenants of its Indenture of Trust. The trustee approved a short-term extension of this deadline, and the commission published its audited financial statements on May 16, 1994.
- In the course of studying its investment practices, the commission learned that two of its investments potentially did not meet the standards for legally permitted investments. The commission has since liquidated those two investments, with a negligible effect on net income.

Finally, during the course of our audit fieldwork, it was discovered that that a commission employee had filed fraudulent payment documents totalling approximately $11,000. The commission has terminated the employee and referred the matter to the Minneapolis City Attorney's Office for possible criminal prosecution.

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

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

Mr. Henry Savelkoul, Chairman
Metropolitan Sports Facilities Commission

Members of the Metropolitan Sports Facilities Commission

Mr. William Lester, Executive Director
Metropolitan Sports Facilities Commission

Audit Scope

We have audited the financial statements of the Metropolitan Sports Facilities Commission as of and for the year ended December 31, 1993, and issued our report (#94-23) thereon dated April 1, 1994, except for footnotes 8 and 9, as to which the date was April 29, 1994. 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:

- cash and investments,
- operating revenue,
- operating expenses,
- payroll and,
- fixed asset inventory.

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.

Management Responsibilities

Management of the Metropolitan Sports Facilities Commission 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.

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.

Instance of Employee Theft

During the course of our audit fieldwork, it was discovered that a commission employee had filed fraudulent payment documents totaling approximately $11,000. Commission staff uncovered the theft after our auditors questioned unusual variances in an expense account. The theft appears to be an isolated case. It did not occur because of any significant deficiencies in the internal control structure and was detected on a timely basis. With the assistance of its attorneys, the commission has completed a thorough investigation and forwarded the results to the Minneapolis City Attorney's Office for possible criminal prosecution.

Extension of Deadline for Publishing Audited Financial Statements

Due to concerns about its investment losses, as discussed in the next section, the commission delayed publication of its audited financial statements. Footnote 5 to the financial statements indicates that:

> The Commission requested and received from the Trustee an extension of the date specified under the Indenture of Trust by which the Commission's audited financial statements and certain related documents otherwise would have been required to be filed with the Trustee (i.e., 120 days following the end of the Commission's fiscal year, or April 30).

Pursuant to the extension, the Commission's audited financial statements were filed with the Trustee on May 13, 1994. The audited financial statements were released as a public document on May 16, 1994.

Subsequent Events Concerning Investments

In March and April 1994, the commission began experiencing problems with its investments. The market value of certain investments showed a significant decline. The commission took immediate action to dispose of the most impaired investments. It disclosed the subsequent investment losses in note 9 to its audited financial statements. The commission has continued to conduct a comprehensive study of its investment policies and practices. During the course of its study, the commission discovered that two investments may not have complied with the restrictions established by state law and the Indenture of Trust. The commission has since taken action to ensure that its full investment portfolio complies with the applicable legal provisions.

As of December 31, 1993, the Metropolitan Sports Facilities Commission audited financial statements show investments at a value of $30,339,218. As explained in note 9 to the financial statements, the commission experienced a subsequent decline in the market value of its investments:

> Between December 31, 1993, and the close of business on April 29, 1994, the commission liquidated two of its investments for an aggregate loss of $1,750,241 and experienced a $413,500 decline in the aggregate market value of its remaining investments. Of the decline experienced, the portion related to investments with trustee was an unrealized loss of $279,000. The decline in value is primarily attributable to the sharp rise in interest rates during the months of March and April 1994 and its effects upon the U.S. Government Securities market.

Following the publication of its audited financial statements, the commission continued to conduct a comprehensive study of its investment policies and practices. Pending the outcome of its study, we have withheld the issuance of this report on the commission's internal control structure and compliance with finance-related legal provisions. As part of its study, the commission's legal counsel asked broker-dealers to confirm that commission investments were legally allowable. Commission investments are restricted by Minn. Stat. Section 475.66 governing investing by various public bodies, as well as the Indenture of Trust between the Metropolitan Council and Norwest Bank Minnesota. Two broker-dealers identified commission investments that did not comply with these legal provisions.

- As of December 31, 1993, the commission held an investment of $61,255 in the Fidelity Institutional Cash Portfolios - Class A - Money Market Portfolio. By June 6, 1994, the commission had increased its investment in this interest bearing money market account to over $2 million. In a letter dated June 8, 1994, the broker-dealer notified the commission that the investment did not comply with the legal restrictions governing commission investments. However, due to a problem with its internal communications, the commission continued to place additional significant funds in this investment, accumulating over $14.7 million in the account. Finally, on August 26, 1994, the commission directed the broker-dealer to sell its interest in this money market account. Upon liquidation, the commission recovered its full investment and earned a modest amount of interest income.

- In January 1994, the commission purchased a $1.4 million investment in the Fortress Government Income Securities, Inc. (GISI). On May 20, 1994, the broker-dealer indicated that GISI contained some investment in put and call options and futures contracts. The broker-dealer further acknowledged that Minnesota Statutes did not authorize the commission to hold such investments. The commission sold this investment on May 24, 1994 at a net loss of about $48,000.

Prior to receiving the certifications from these two broker-dealers, commission management represented to us that to the best of their knowledge the commission investments complied with Minnesota Statutes and the Indenture of Trust. Ultimately, after learning of the compliance problems, the commission sold its interest in these two investments with a negligible effect on net income.

Conclusions

We noted no matters involving the internal control structure and its operations that we consider to be a material weakness. 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 conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above.

The results of our tests of compliance indicate that, except for the two investments that did not comply with applicable legal provisions as previously discussed, and the issues discussed in findings 1 and 2, and considering the Trustee's agreement to extend the deadline for the Commission to file its audited financial statements, with respect to the items tested, the Metropolitan Sports Facilities Commission complied, in all material respects, with the provisions referred to in the audit scope paragraphs. With respect to items not tested, nothing else came to our attention that caused us to believe that the commission had not complied, in all material respects, with those provisions.

Pursuant to Minn. Stat. Section 3.975, we are referring this report to the Attorney General. As previously discussed, we found that a commission employee had stolen $11,000 by filing false payment documents. Minn. Stat. Section 3.975 requires us to report such instances to the Attorney General and the Legislative Audit Commission.

We also noted other matters that we reported to the management of the Metropolitan Sports Facilities Commission at the exit conference held on April 15, 1994.

This report is intended for the information of the Legislative Audit Commission and management of the Metropolitan Sports Facilities Commission. This restriction is not intended to limit the distribution of this report, which was released as a public document on September 14, 1994.

We thank the Metropolitan Sports Facilities Commission staff for their cooperation during this audit.

James R. Nobles
Legislative Auditor

John Asmussen, CPA
Deputy Legislative Auditor

End of Fieldwork: April 1, 1994, except for footnotes 8 and 9 to the financial statements, as to which the date was April 29, 1994, and except for the two commission investments that did not comply with statutory provisions, as to which the date was August 26, 1994.

Report Signed On: Sepember 7, 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
Jeanine Leifeld, CPA	Audit Manager
Sonya Hill, CPA	Auditor-in-Charge
Janet Knox, CPA	Auditor
Jenny Lee	Auditor

Exit Conference

The findings and recommendations in this report were discussed with the following staff of the Metroplitan Sports Facilities Commission at the exit conference held on April 15, 1994:

William Lester	Executive Director
Roger Simonson	Director of Finance
Paul Thatcher	Finance Committee Chair

Current Findings and Recommendations

1. The Metropolitan Sports Facilities Commission did not properly collateralize bank balances during the year.

The commission did not have sufficient collateral for its deposits on 37 days during the year. Minn. Stat. Section 118.01, subd. 2 requires:

> ...the total in amount of collateral computed at its market value shall be at least ten percent more than the amount on deposit at the close of the business day, in excess of any insured portion...

The bank has assigned a $500,000 government note to the commission as collateral. However, in 37 instances throughout calendar year 1993, the government note was not sufficient to collateralize the commission's account balances on those days. The uncollateralized balances averaged $442,000 for the 37 days. The commission should develop a process of monitoring account balances to ensure that the bank properly collateralizes commission deposits as required by Minn. Stat. Section 118.01.

Recommendation

- *The commission should secure sufficient collateral as required by Minn. Stat. 118.01 in order to properly collateralize its deposits.*

2. The Metropolitan Sports Facilities Commission improperly accrued and paid an employee for sick and holiday pay.

The commission allowed an employee to accrue sick leave while not working, in apparent violation of the commission's personnel policies. The commission's personnel policy only allows full-time employees to accrue benefits, including leave and holiday pay. The employee had exhausted all available vacation and sick leave and was not working regular hours due to an extended illness. However, even though the employee was not working, the director of operations authorized the payroll clerk to accrue additional sick leave for the employee and to pay the employee for any holidays during the pay period. The total amount this individual received was $1,288 between January 1, 1993 and February 26, 1994. The director of operations stated that he expected the employee to return to work. As currently stated, the commission's personnel policies do not clearly allow the commission to grant nonworking employees these additional benefits.

Recommendations

- *The commission should determine whether the employee should repay the sick and holiday benefits received.*

- *The commission should clarify its personnel policies concerning payment of sick and holiday benefits to an employee during an extended illness.*

METRODOME

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September 7, 1994

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Gentlemen:

This letter is delivered to you to respond, as you have requested, to the Current Findings and Recommendations and certain other matters raised in your Management Letter, which is a part of your financial and compliance audit of the Metropolitan Sports Facilities Commission (Commission) for the year ending December 31, 1993.

<u>FINDING ONE:</u>

The first finding is that the Metropolitan Sports Facilities Commission did not properly collateralize bank balances during the year. The Commission has requested and received an additional $300,000 in collateral to ensure against uncollateralized bank balances. Total collateralization is now at $900,000. This amount of collateral should be sufficient to cover any float that the Commission may have in ensuring against any outstanding checks that had not been paid by the bank. The basic reason for uncollateralized balances in 1993 stem from outstanding checks including a $2,676,083 check that was issued on October 15, 1993 and did not clear our checking account until October 28, 1993 -- a period of thirteen days. Please be assured that should we not have cooperation of our bank we will seek another institution which is responsible to the collateralization needs of this public body. Roger Simonson, the Commission's Finance Director, has the oversight responsibility for this matter.

FINDING TWO:

Your second finding is that the Commission improperly accrued and paid an employee for sick and holiday pay. As noted in your findings, the employee had exhausted all available vacation and sick leave and was not working regular hours due to an extended illness. You recommend that the Commission determine whether the employee should repay the sick and holiday benefits received and secondly, that the Commission clarify its personnel policies concerning payment of sick and holiday benefits to an employee during an extended illness. The payment to this individual in the amount of $1,288 was an oversight and the result of an unclear policy in the personnel manual. We intend to rewrite the policy to clarify that such employees are not allowed to accrue benefits, including vacation and holiday pay, in the future. William Lester, the Commission's Executive Director, is responsible for the completion of this policy revision.

EMPLOYEE THEFT:

Upon discovery of the instance of employee theft noted in your letter, the Commission reported the matter as required by law and with the aid of Commission counsel fully investigated the matter, ultimately reporting its findings to the appropriate law enforcement officials. The Commission has submitted a claim for the loss. The employee involved was terminated by the Commission.

INVESTMENTS:

In the course of our discussion with your staff during the audit process and in the exit interview of April 15, 1994 involving your staff, a Commission member and our staff, it was reported to your staff that certain unrealized investment losses had occurred after December 31, 1993. The Commission immediately turned its attention to the investment losses, and the Commission's investment practices and policies.

With regard to the investment losses,the Commission determined that the major portion of the losses were attributable to investments in mutual funds which had substantial positions in collateralized mortgage obligations and certain other securities commonly referred to as derivatives, most notably, the Piper Institutional Government Income Portfolio. These losses were substantially greater than those which occurred in the Commission's customary investments in government fixed income securities. The Commission is currently undertaking an investigation and analysis with its legal counsel to determine whether the Commission has legal recourse with regard to losses suffered as a result of those investments.

The Commission then undertook a comprehensive study of its financial and investment policies and practices aided by the certified public accounting firm of Coopers & Lybrand. The final report of Coopers & Lybrand has not yet been received by the Commission.

Over the course of the ensuing months, the Commission forged a new written investment policy, supplementing the limitations on Commission investments imposed by state law and the Indenture of Trust governing the Metrodome Revenue Refunding Bonds, Series 1992. In parallel with this effort, the Commission undertook a search for an independent investment adviser, conducted interviews and, at its July 20, 1994 meeting, selected Sit Fixed Income Advisors to manage Commission investments on a discretionary basis, subject to Commission investment policy. The Commission also solicited proposals for an investments custodian, a process which culminated in the selection of Norwest Bank Minnesota.

Your Management letter also refers to certain investigations initiated by the Commission to independently confirm compliance with the permitted investment provisions of state law and the Indenture. The letter of Commission counsel to Mr. Liefeld of your office, dated August 19, 1994, adequately describes those efforts. As noted therein, the Commission has directed its counsel to determine what legal remedies, if any, may be available to the Commission against broker dealers arising from non-compliance with state law. On this same subject, it should be noted that the new Commission investment policy and the Commission's contract with its investment adviser require the adviser to annually certify in writing that all Commission investments under management comply with applicable state law and the Indenture.

Thank you for your assistance and cooperation during this audit.

Sincerely,

William J. Lester
Executive Director

cc: Henry J. Savelkoul, Chairman, MSFC
Paul R. Thatcher, Chairman, Finance Committee, MSFC