HIGHER EDUCATION BOARD

FINANCIAL AUDIT

FOR THE PERIOD JULY 1, 1991 THROUGH JANUARY 31, 1994

SEPTEMBER 1994

Financial Audit Division Office of the Legislative Auditor State of Minnesota

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State of Minnesota
Office of the Legislative Auditor
Centennial Office Building • St. Paul, MN 55155
612/296-4708

HIGHER EDUCATION BOARD

FINANCIAL AUDIT FOR THE PERIOD JULY 1, 1991 THROUGH JANUARY 31, 1994

Public Release Date: September 16, 1994

No. 94-51

OBJECTIVES:

- ASSESS INTERNAL CONTROL STRUCTURE: Payroll, capital equipment and all administrative disbursements.
- TEST COMPLIANCE WITH CERTAIN FINANCE-RELATED LEGAL PROVISIONS.

CONCLUSIONS:

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

- The board's controls over its fixed assets are inadequate.
- Controls over access to statewide accounting and payroll/personnel transactions are inadequate.

We found one departure from finance-related legal provisions:

• The board failed to encumber funds in a timely manner.

Contact the Financial Audit Division for additional information.

296-1730

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. Archie D. Chelseth, Chair Higher Education Board

Members of the Higher Education Board

Dr. Jay Noren, Chancellor Higher Education Board

Audit Scope

We have completed a financial related audit of the Higher Education Board for the period of July 1, 1991 through January 31, 1994 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 board'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:

- payroll,
- capital equipment, and
- all other disbursements.

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.

Senator Phil Riveness, Chair Members of the Legislative Audit Commission Mr. Archie D. Chelseth, Chair Members of the Higher Education Board Dr. Jay Noren, Chancellor Page 2

Management Responsibilities

Management of the Higher Education 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.

Unauthorized Provision in an Employment Contract

On behalf of the Higher Education Board, Mr. Chelseth, the chairman, hired Dr. Jay Noren as the board's interim chancellor. Due to the difficulties in recruiting for an interim chancellor, a temporary position, the employment contract included a contingency clause which stated that "The Board will grant severance pay equal to one year's salary for any involuntary separation, except for cause, including legislative failure to continue and /or fund the Higher Education Board in FY 94-"95". When Mr. Chelseth negotiated the contract in January 1993, the continued existence of the board was being debated by the state legislature. The legislature ultimately preserved the board and subsequently the severance provision lapsed.

However, we found no statutory authority or other empowerment to the chairman which authorized him to commit the state or the board to pay severance had the involuntary termination occurred.

Senator Phil Riveness, Chair Members of the Legislative Audit Commission Mr. Archie D. Chelseth, Chair Members of the Higher Education Board Dr. Jay Noren, Chancellor Page 3

Conclusions

Our audit disclosed the conditions discussed in findings 1 and 2 involving the internal control structure of the Higher Education 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. However, we believe none of the reportable conditions described above is a material weakness.

The results of our tests of compliance indicate that, except for the issues discussed in finding 3, and the matter discussed in the previous section, with respect to the items tested, the Higher Education 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 Higher Education 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 Board. This restriction is not intended to limit the distribution of this report, which was released as a public document on September 16, 1994.

John Asmussen, CPA
Deputy Legislative Auditor

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

James R. Nobles'
Legislative Auditor

End of Fieldwork: March 23, 1994

Report Signed On: September 12, 1994

Higher Education 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
Tom Donahue, CPA	Audit Manager
Carl Otto, CPA	Auditor-in-Charge
Marla Conroy, CPA	Auditor

Exit Conference

The findings and recommendations presented in this report were discussed with the following staff of the Higher Education Board at an exit conference held on September 1, 1994:

Dr. Jay Noren	Chancellor
Ed McMahon	Vice Chancellor for Administration and Budget
Linda Hanson	Administrative Assistant to the Chancellor

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Higher Education Board

Introduction

The Higher Education Board operates under Minn. Stat. Chapter 136E. The board presently consists of 16 members appointed by the governor with advice and consent of the senate. The membership includes a student representative from each of the three higher education systems. The mission of the board is to provide programs of study that meet the needs of students for occupational, general, baccalaureate, and graduate education. The board shall develop administrative arrangements that make possible the efficient use of the facilities and staff of the former technical colleges, community colleges, and the state universities. In carrying out the merger of the three separate systems, the board shall control administrative costs by eliminating duplicative administrative positions and course offerings.

The Laws of Minnesota for 1991 stated that the board shall hire a chancellor on an interim basis for the period ending June 30, 1995. Dr. Jay Noren was hired as the interim chancellor beginning March 15, 1993.

Since the boards inception in fiscal year 1992, its administrative and accounting functions have been within the Department of Administration, the Higher Education Coordinating Board, and as of September 1, 1993, the State University System.

Table 1 shows expenditures of the board since its inception broken out by fiscal year:

	Table 1 Education Board Ex I Years 1992, 1993, a	•	
	<u>1992</u>	<u>1993</u>	<u>1994*</u>
Payroll Capital Equipment Other Expenditures	\$69,184 18,287 <u>64,529</u>	\$ 67,048 9,622 <u>268,399</u>	\$132,434 40,629 <u>137,179</u>
Total	<u>\$152,000</u>	<u>\$345,069</u>	<u>\$310,242</u>
* through 1/31/94			
Source: Statewide Accounting System	accounting reports.		

Current Findings and Recommendations

1. The Minnesota Higher Education Board's controls over fixed assets are inadequate.

The Minnesota Higher Education Board needs to improve controls over fixed assets in several areas. The board does not properly identify its fixed assets. The board has not conducted physical inventories or spot-checks to verify the existence of inventory items.

The board has not properly marked its fixed assets or conducted a physical inventory or spot check. Through January 1994, the board purchased a total of \$68,539 of capital equipment. We identified thirteen assets acquired prior to September 1993 that have not been marked with state identification number labels, although numbers had been assigned. There is currently a question of whether one piece of computer equipment is the property of HEB or the community college system. The proper marking of assets is critical to identify ownership and to facilitate efficient physical counting and spot checks.

The board has not clearly assigned fixed asset duties. The Department of Administration, Higher Education Coordinating Board and the State University System offices have each played a role in performing accounting functions for the board. As a result of this instability it has been difficult for the board to establish the proper control over fixed assets.

Recommendation

- The Higher Education Board should improve controls over fixed assets by:
 - -- properly and promptly marking new fixed assets with an identification number label:
 - -- clearly delegating fixed asset responsibilities and developing procedures for maintaining accurate inventory records; and
 - -- Taking a complete physical inventory of fixed assets, and subsequently performing periodic spot-checks to asses inventory accuracy and identify missing assets.

2. Controls over access to statewide accounting and payroll/personnel transactions are inadequate.

The Department of Administration and the Higher Education Coordinating Board were former fiscal agents for the board but are no longer responsible for processing board transactions. However, several employees of the Department of Administration and the Higher Education Coordinating Board still have access to the board's accounting and payroll/personnel data. There

Higher Education Board

is an increased risk of errors and irregularities occurring when controls over access are not monitored.

Recommendation

• The Higher Education Board should improve controls over statewide accounting and payroll/personnel systems by restricting access. Only the current fiscal agents should have access to process data for the board.

3. The Higher Education Board failed to encumber funds in a timely manner.

The board allowed a contractor to begin work prior to the encumbrance of funds. Also, the board ordered computer equipment prior to the encumbrance of funds. Minn. Stat. 16A.15, Subd. 3 provides that "A payment may not be made without prior obligation. An obligation may not be incurred against any fund, allotment, or appropriation unless the commissioner has certified a sufficient unencumbered balance...to meet it." The Department of Finance Operating Policies and Procedures 06:04:30 states that the funds must be encumbered prior to sending the purchase order to the vendor.

Without following state purchasing guidelines regarding bids and contracting for services, the board may be incurring additional costs. Liabilities for goods and services could be incurred without having funds obligated for those expenditures.

Recommendation

• The Higher Education Board should comply with Minn. Stat. Section 16A.15, Subd. 3 and Department of Finance operating procedure 06:04:30.



Community Colleges • State Universities • Technical Colleges

September 9, 1994

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

Dear Mr. Nobles:

Thank you for the opportunity to respond to the audit report dated August 8, 1994. The Minnesota State Colleges and Universities are faced with the difficult task of completing the merger with limited staff and financial resources. We believe the audit will help us establish an effective internal control structure. The following is our response to the individual audit recommendations:

1. The Minnesota Higher Education Board's controls over fixed assets are inadequate.

We concur with the recommendation. However, a fixed asset inventory is not possible at this time due to limited staff resources and the large number of tasks that must be done for the merger. We will implement this recommendation and address how to inventory the equipment and furniture of the Technical Colleges when they become state property as resources permit.

2. Controls over access to statewide accounting and payroll/personnel transactions are inadequate.

We concur with the recommendation, and will remove access for the Department of Administration and Higher Education Coordinating Board staff. Gerry Rushenberg is responsible for implementing the recommendation.

3. The Higher Education Board failed to encumber funds in a timely manner.

We concur in the recommendation. In the future, we will encumber funds before making purchases or allowing contractors to begin work. Mary Stanton will work with budget managers on contracts, and Darla Sassor will work with them on other purchases.

Jay Noren, Chandellor

Sincerely.

Minnesota State Colleges and Universities



September 9, 1994

Mr. James Nobles Office of the Legislative Auditor State of Minnesota Centennial Building St. Paul, MN 55155

Dear Mr. Nobles:

While the Chancellor's Office will be formally responding to your draft audit report summarizing the results of the Higher Education Board audit for July 1, 1991 through January 31, 1994, I want to comment on the language on page 2 of the draft letter.

The draft audit indicates that, as Board Chair, I "hired" Dr. Jay Noren as the Board's interim chancellor. The draft further indicates the Interim Chancellor's employment "contract" included a clause that the Board would provide pay equal to one year's salary if the Legislature did not continue or did not fund the merger in the next fiscal year. The draft audit letter questions whether there was legislative or Board authority for the Chairman to make such a commitment.

As Board chairman, I did not "hire" a Chancellor. As the Board minutes of January 19, 1993 reflect, the Chancellor "...was unanimously elected (by the Board) with one abstention." After the Board election, I was directed, as Chairman, to negotiate terms and conditions of employment mutually agreeable to the successful candidate and the Board.

Those negotiations were carried out with the knowledge and concurrence of the Board Vice Chair, the Chair of the Board's Search Committee and a majority of the Board members themselves.

The 1991 Legislature directed the Board to hire a chancellor upon the completion of a national search. Despite extraordinarily difficult constraints and a tumultuous political climate in both the 1992 and 1993 legislative sessions, our Board successfully carried out its responsibilities. We did so in good faith and, in our understanding at the time, within the intent and spirit of our legislative mandate.

Thank you for this opportunity to comment on your draft.

Sincerely,

Archie D. Chelseth

Chairman

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