

# Department of Military Affairs

## Financial Audit

For the Year Ended June 30, 1994

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June 1995

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Financial Audit Division  
Office of the Legislative Auditor  
State of Minnesota

95-27



# SUMMARY

State of Minnesota

Office of the Legislative Auditor

Centennial Office Building • St. Paul, MN 55155  
612/296-4708

## Department of Military Affairs

### Financial Audit For the Year Ended June 30, 1994

Public Release Date: June 28, 1995

No. 95-27

#### Objectives

Evaluate internal control structure: Military construction, Army and Air National Guard reimbursements (CFDA #12.000), payroll, and state and federal administrative expenditures.

Test compliance with certain finance-related legal provisions.

#### Conclusions

We found one weakness in the internal control structure over contracts:

- The department needs to have all contracts approved by the Attorney General or a delegate, fully obligate funds prior to executing contracts, and keep copies of executed contracts on file in the department.

We found two departures from finance-related legal provisions:

- The department inappropriately borrowed money from the Minnesota State Armory Building Commission to purchase land to accommodate an operations and maintenance shop.
- The department provides administrative services to STARBASE Minnesota, Inc., a private non-profit corporation and grantee. The department disbursed grant money in excess of the grantee's immediate need. Also, STARBASE Minnesota, Inc. failed to obtain an audit under the OMB Circular A-133.

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

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## Members of the Legislative Audit Commission

Major General Eugene R. Andreotti, Adjutant General  
Department of Military Affairs

## Audit Scope

We have completed a financial related audit of the Department of Military Affairs for the period July 1, 1993 through June 30, 1994, as outlined below, and as further discussed in the Introduction. The work conducted in the department is part of our Statewide Audit of the State of Minnesota's fiscal year 1994 financial statements and Single Audit (federal compliance audit). The Single Audit coverage satisfies the federal government's financial and compliance audit requirements for all federal programs administered by the department during fiscal year 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.

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

- military construction, Army and Air National Guard reimbursements (CFDA #12.000),
- state and federal administrative expenditures, and
- payroll.

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 Department of Military Affairs 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 condition discussed in Finding 2 involving the internal control structure of the Department of Military Affairs. 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 conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we believe none of the reportable conditions described above are material weaknesses.

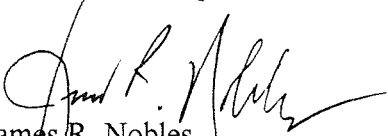
The results of our tests of compliance indicate that, except for the issues discussed in Findings 1 through 3, with respect to the items tested, the Department of Military Affairs complied, in all

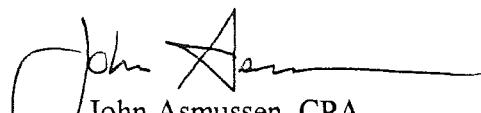
material respects, with the provisions referred to in the audit scope paragraphs. With respect to the items not tested, nothing else came to our attention that caused us to believe that the Department of Military Affairs had not complied, in all material respects, with those provisions.

We also noted other matters involving the internal control structure and its operation and/or compliance with laws and regulations that we reported to the management of the Department of Military Affairs at the exit conference held on June 21, 1995.

This report is intended for the information of the Legislative Audit Commission and management of the Department of Military Affairs. This restriction is not intended to limit the distribution of this report, which was released as a public document on June 28, 1995.

We thank the Department of Military Affairs staff for their cooperation during this audit.

  
James R. Nobles  
Legislative Auditor

  
John Asmussen, CPA  
Deputy Legislative Auditor

End of Fieldwork: March 31, 1995

Report Signed On: June 22, 1995





## Department of Military Affairs

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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
Janet Knox, CPA	Audit Supervisor
Mark Mathison	Auditor

### Exit Conference

The findings and recommendations in this report were discussed with the following staff of the Department of Military Affairs on June 21, 1995:

Eugene Andreotti	Adjutant General
Gary LaBlanc	Chief of Staff
Thomas Ryan	Executive Director
Marlene Anderson	Accounting Supervisor
Julio Barron	Judge Advocate
Terry Palmer	Executive Director, State Armory
	Building Commission



# Department of Military Affairs

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## Introduction

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The Department of Military Affairs consists of the military forces of the state of Minnesota, the Office of the Adjutant General, civilians employed for administrative and maintenance services, and state owned military installations. The Adjutant General, as commander of the Minnesota National Guard, heads the Department of Military Affairs. The Adjutant General accepts federal monies on behalf of the state for military forces and executes related agreements and contracts for armory construction, improvements, and maintenance programs. General Eugene R. Andreotti is the Adjutant General.

The Adjutant General also serves as chair of the Minnesota State Armory Building Commission. The commission is chartered as a corporation. It is responsible for financing the construction of new National Guard armories and maintaining those armories until the debt is retired and the property is transferred to the state.

The Minnesota National Guard serves both a state mission and a federal mission. Minnesota's National Guard is the organized militia of the state of Minnesota, under the command of the Governor. At the same time, the members of the Minnesota Air and Army National Guard are reserve members of the U.S. Army and Air Force and may be called into active service by the President of the United States. The Guard operates 61 armories, 17 organizational maintenance shops, 5 motor vehicle storage buildings, the Camp Ripley Reservation, and an Army air base at the St. Paul downtown airport. The Air National Guard is stationed at a state owned air base in Duluth and at a federally owned and operated air base at the Minneapolis-St. Paul International Airport.

The Minnesota National Guard reported federal operating expenditures of \$156.1 million for federal fiscal year 1994. Federal funding is appropriated from the U.S. Department of Defense through the National Guard Bureau in Washington, D.C. Some expenses incurred by the state are reimbursed with federal funds. These reimbursements are governed by cooperative funding agreements between the Department of Military Affairs and the National Guard Bureau. During fiscal year 1994, the department reported \$12,152,333 in federal program expenditures. For fiscal year 1994, the department received a General Fund appropriation of \$9,248,000. Our audit scope did not include federal funds expended directly by the Minnesota National Guard nor expenditures of the Minnesota Armory Building Commission.

## Department of Military Affairs

Table 1-1 summarizes the department's sources and uses of funds for fiscal year ended June 30, 1994.

<b>Table 1-1</b>	
<b>Summary of Financial Activity</b>	
<b>Fiscal Year Ended June 30, 1994</b>	
<u>Sources</u>	
General Fund appropriation	\$ 9,248,000
Federal Cooperative Agreement reimbursements	12,478,776
Other	<u>1,700,929</u>
Total Sources	<u>\$23,427,705</u>
<u>Expenditures</u>	
State administrative expenditures	\$ 6,208,178
Federal administrative expenditures	3,944,442
Payroll	11,758,996
Building Construction	1,482,621
Other	<u>33,468</u>
Expenditure Total	<u>\$23,427,705</u>

Sources: Statewide Accounting System Estimated Actual Receipt Report and Manager's Financial Report as of 9/2/94.

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## Current Findings and Recommendations

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**1. The Department of Military Affairs inappropriately borrowed \$175,247 from the Minnesota State Armory Building Commission (MSABC) to purchase land.**

During fiscal year 1994, the department inappropriately borrowed \$175,247 from the Minnesota State Armory Building Commission. The department used the borrowed funds to purchase land to accommodate an operations and maintenance shop. The department did not receive a direct appropriation for the land purchase.

Minn. Stat. Section 190.25, Subd. 1, authorizes the Adjutant General to purchase lands "subject to funds appropriated and available." Subd. 2, states "...the Adjutant General may use funds that are directly appropriated for the acquisition of land." During fiscal year 1994, there were no funds directly appropriated to purchase land, nor were funds otherwise available from appropriated sources. Federal funds were available to pay for construction of an operations and maintenance shop, however, the department needed to contribute the land. In order to procure the federal funds for construction, the department borrowed \$175,247 from the MSABC to purchase the land.

The duties of the Minnesota State Armory Building Commission are prescribed in Minn. Stat. Section 193.143. Those duties include financing the construction of new National Guard armories by issuing revenue bonds. Additionally, the MSABC is responsible for maintaining those armories until the bond debt is retired. The duties do not appear to include loaning funds to the department. The MSABC does not have the authority to make loans.

*Recommendation*

- *The Department of Military Affairs should comply with Minnesota laws which authorize the purchase of land subject to funds appropriated and available.*

**2. The Department of Military Affairs entered into contracts that did not comply with Minnesota Statutes.**

The department entered into several contractual agreements without the approval of the Attorney General or a delegate. In addition, the department did not obligate available funds for the full amount of contract liabilities. Finally, the department did not keep all executed contracts on file at the agency.

Minn. Stat. Section 16B.06 sets out the requirements for contract management and review. Among the provisions are the requirements that: (1) the Attorney General or a delegate approve state contracts, as to the form and execution, in order for a contract to be valid; (2) that the state's accounting system shows an allotment or encumbrance balance for the full amount of the contract

## Department of Military Affairs

liability; and (3) that contracting agencies keep copies of fully executed contracts on file in the agency.

The Department of Military Affairs entered into contract agreements that did not comply with those provisions of Minn. Stat. Section 16B.06. The department had properly executed the contracts but the Attorney General, or a delegate, had not approved several contracts that we reviewed. We also determined that the department executed contracts prior to encumbering funds. For example, the department entered into a land acquisition contract in April, 1993, with a liability of \$11,000. The department did not encumber the liability until the day prior to the closing on September 29, 1993. Also, as of March 28, 1995, the department had not encumbered funds of \$19,480 for another contract which was signed February 4, 1994.

The department does not keep all copies of executed contracts on file in the agency. A National Guard member keeps some contract files off-site. This person assists the department's real estate transactions as part of his National Guard duties.

### *Recommendations*

- *The department should have all contracts reviewed and approved by the Attorney General or a delegate.*
- *The department should fully obligate funds prior to executing contracts.*
- *The department should keep copies of executed contracts, and related material, on file at the agency.*

### **3. The Department of Military Affairs has an improper relationship with a private non-profit corporation. Also, the grantee has not complied with the Single Audit Act.**

The department provides administrative services to a private non-profit corporation. It also grants federal funds to this corporation, but does not exercise prudent cash management practices in disbursing grant funds. Also, the non-profit corporation did not receive an independent audit of the federal funds, as required by the Single Audit Act.

The department entered into a grant contract with STARBASE Minnesota, Inc., to implement an educational program funded by federal funds. The department makes disbursements from the state treasury and deposits the funds directly into the corporation's checking account. An employee of the department maintains the corporation's accounting records, disburses its vendor payments and payroll, and reconciles the monthly bank statements with accounting records. It is not an appropriate use of state resources to provide administrative services to a legally separate entity such as STARBASE Minnesota, Inc. The department should make payments of funds granted to the corporation and the corporation should be responsible for administering those funds.

Over a nine-month period of fiscal year 1994, the department made six deposits, averaging \$50,000 each, into the corporation's checking account. The department disbursed more money than required to meet immediate program expenditures. Average monthly program expenses

## Department of Military Affairs

were approximately \$21,000. Therefore, excess funds accumulated in the checking account. The department should match payments to the corporation with program expenditures in order to minimize the time between disbursement and reimbursement of federal funds in the state treasury.

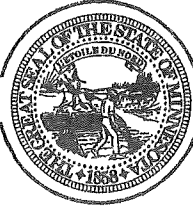
During fiscal year 1994, the department disbursed \$280,000 of federal financial assistance to STARBASE Minnesota, Inc. STARBASE Minnesota, Inc. did not receive a financial and compliance audit made in accordance with OMB Circular A-133 for fiscal year 1994. STARBASE Minnesota, Inc. must comply with the Single Audit Act. The Single Audit Act requires grantees receiving direct and indirect federal assistance of \$100,000 or more to obtain an audit by an independent auditor. Grantees must file a report with the Office of the State Auditor within six months of their fiscal year end.

### *Recommendations*

- *The department should discontinue providing administrative services to the grantee.*
- *The department should disburse funds to the grantee in a manner that matches the disbursement with current program expenditures.*
- *STARBASE Minnesota, Inc. should obtain an independent financial and compliance audit.*

# DEPARTMENT OF MILITARY AFFAIRS

MINNESOTA ARMY AND AIR NATIONAL GUARD



OFFICE OF THE ADJUTANT GENERAL

VETERANS SERVICE BUILDING

STATE OF MINNESOTA

20 WEST 12TH STREET

ST. PAUL, MINNESOTA 55155-2098

15 June 1995

Mr. James R. Nobles  
Legislative Auditor  
Centennial Building  
St. Paul, MN 55155

Dear Mr. Nobles:

The following comments are furnished relative to the draft audit report summarizing the results of your audit work for this agency for the fiscal year ending June 30, 1994.

## Current Findings, Recommendations, and Responses

### Recommendations:

The Department of Military Affairs should comply with Minnesota laws which authorized the purchase of land subject to funds appropriated and available.

### Department Response:

The Department of Military Affairs will comply with Minnesota laws with respect to the purchase of land. The Minnesota State Armory Building Commission, while not part of the formal audit, does question the comments with respect to the powers as outlined in Minn. Stat. 193.143. The powers of the MSABC, include "all the powers of a body corporate necessary and convenient to accomplish the objectives" listed, and further, the statute explicitly states that the listed powers "shall not be construed as a limitation on the general powers hereby conferred". The commission asserts that under this language, it does have the authority to make loans and to perform other acts in furtherance of its statutory objectives and duties.



The department should have all contracts reviewed and approved by the Attorney General or a delegate.

Department Response:

The department will have all contracts reviewed and approved by the Attorney General or a delegate. The department will seek delegation authority from the Attorney General to facilitate contracting procedures.

The department should fully obligate funds prior to executing contracts.

Department Response:

The department will fully obligate funds prior to executing contracts.

The department should keep copies of executed contracts, and related material, on file at the agency.

Department Response:

The department will obtain and keep copies of executed contracts and related material on file at the agency.

The department should discontinue providing administrative services to the grantee.

Department Response:

By correspondence dated February 16, 1993, Attorney General Humphrey states that his office reviewed the STARBASE, MN implementation plan for the federal fiscal year ending 30 September 1993. He states "The operations and activities proposed for federal funding under the plan are hereby approved." The documentation which the Attorney General's Office reviewed contains a section entitled "Technical Support." This section specifically provides: "The Finance Directorate will handle all personnel matters as well as act as fiscal agent. Services to be provided will include but not be limited to purchases, contracts, leases, and payments." These provisions remain unchanged in the current 1995 STARBASE agreement between the National Guard Bureau and the State of Minnesota.

Given that federal funds derived from the National Guard Bureau are provided to the Department of Military Affairs in support of STARBASE, Minnesota, Inc., it seems appropriate for this agency to provide limited administrative support for the STARBASE program. Note, however, this administrative support is of limited duration. In June 1996, federal funding via the National Guard Bureau will be terminated; at this time STARBASE, Minnesota, Inc. will become a self-sufficient entity. The Department of Military Affairs will then cease providing any administrative support to the organization.

The department should disburse funds to the grantee in a manner that matches the disbursement with current program expenditures.

Department Response:

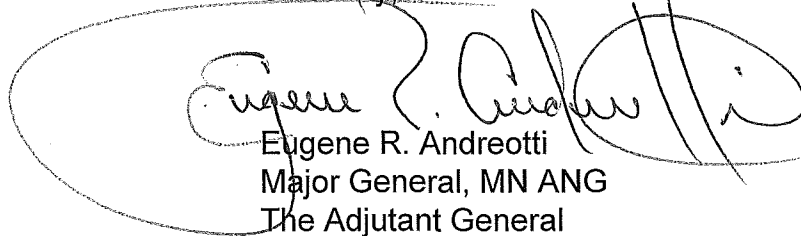
The department will disburse funds to the grantee as costs are incurred. To facilitate the proper accounting of funds currently awaiting disbursement, the department will initiate the recommended method effective the start of the state fiscal year, 1 July 1995.

STARBASE Minnesota, Inc. should obtain an independent financial and compliance audit.

Department Response:

STARBASE Minnesota, Inc. has been notified of the requirement to obtain an independent financial and compliance audit as required by OMB Circular A-133 and as outlined in the Contract between the Minnesota Department of Military Affairs and STARBASE Minnesota, Incorporated.

Sincerely,



Eugene R. Andreotti  
Major General, MN ANG  
The Adjutant General