Department of Finance

Programs Selected for Fiscal Year 1996 Statewide Audit

March 1997

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Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

97-14

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STATE OF MINNESOTA
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JAMES R. NOBLES, LEGISLATIVE AUDITOR

Members of the Legislative Audit Commission

Mr. Wayne Simoneau, Commissioner
Department of Finance

We have audited selected areas of the Department of Finance for the fiscal year ended June 30, 1996, as further explained in Chapter 1. The work conducted in the department was part of our Statewide Audit of the state of Minnesota's fiscal year 1996 financial statements. The Comprehensive Annual Financial Report for the year ended June 30, 1996, includes our report, issued thereon, dated December 2, 1996. The Minnesota Financial and Compliance Report on Federally Assisted Programs for the year ended June 30, 1996, will include our reports on the supplementary information schedule, internal control structure, and compliance with laws and regulations. We anticipate issuing that report in June 1997. The following Summary highlights the audit objectives and conclusions. We discuss our concerns more fully in the individual chapters of this report.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, as issued by the Comptroller General of the United States. Those standards require that we obtain an understanding of management controls relevant to the audit. The standards require that we design the audit to provide reasonable assurance that the Department of Finance complied with provisions of laws, regulations, contracts, and grants that are significant to the audit. Management of the Department of Finance is responsible for establishing and maintaining the internal control structure and complying with applicable laws, regulations, contracts, and grants.

This report is intended for the information of the Legislative Audit Commission and management of the Department of Finance. This restriction is not intended to limit the distribution of this report, which was released as a public document on March 19, 1997.

James R. Nobles
Legislative Auditor

John Asmussen, CPA
Deputy Legislative Auditor

End of Fieldwork: January 17, 1997

Report Signed On: March 12, 1997

SUMMARY

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Department of Finance

Programs Selected for Fiscal Year 1996 Statewide Audit

Public Release Date: March 19, 1997 No. 97-14

Agency Background

The Department of Finance manages the state's accounting, budgetary, and debt management activities. The department maintains the state's accounting system and monitors controls to prevent unauthorized transactions. The Commissioner of Finance, appointed by the Governor, directs the department's operations. Following Laura King's resignation in October 1996, Wayne Simoneau was appointed commissioner.

Audit Scope and Conclusions

Our work in the Department of Finance is completed as part of our annual Statewide Audit. The primary objective of the Statewide Audit is to render an opinion on the state of Minnesota's financial statements included in its Comprehensive Annual Financial Report for fiscal year 1996. This objective included determining whether the financial statements presented fairly its financial position, results of operations, and changes in cash flows in conformity with generally accepted accounting principles. The Statewide Audit is also designed to meet the requirements of the Single Audit Act of 1984, relating to federal programs.

As part of our work, we gained an understanding of internal controls and determined whether the Department of Finance complied with laws and regulations that may have a material effect on the state's financial statements. Our audit scope focused on the Department of Finance's financial reporting responsibilities and on the following areas that were material to our Statewide Audit objectives in fiscal year 1996: general obligation and state revenue bond sales, debt service transfers, master lease program, school energy loans, appropriation transfers to the University of Minnesota, federal cash management, and statewide indirect costs.

We found that the department must make various changes in its procedures to improve the external financial reporting process in the future. This includes improvements in the procedures for identifying accounts payable and compensated absence liabilities. We also found that the department needs to improve controls over loan receivable accounting and interfund transfers. The department must also work with the Office of the State Treasurer and the Department of Public Safety to improve the timeliness of recording deputy registrar receipt collections. Finally, the department needs to improve controls over payment of appropriations requiring matching funds.

We also concluded that, for the items tested, the department complied with applicable legal requirements governing general obligation and state revenue bond sales, debt service transfers, the master lease program, transfers to the University of Minnesota, federal cash management, and statewide indirect costs.

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Audit Participation

The following members of the Office of the Legislative Auditor prepared this report:

John Asmussen, CPA	Deputy Legislative Auditor
Claudia Gudvangen, CPA	Senior Audit Manager
Joan Haskin, CPA	Auditor-in-Charge
Fubara Dapper, CPA	Senior Auditor
Sonya Hill, CPA	Senior Auditor
Dale Ogren, CPA	Senior Auditor
Laura Dombeck	Staff Auditor
Matt Hoffer	Staff Auditor
Atia Alam	Intern

Exit Conference

The issues in this report were discussed with the following staff from the Department of Finance at the exit conference held on March 4, 1997:

Wayne Simoneau	Commissioner
Rosalie Greeman	Assistant Commissioner
Michael Ladd	Assistant Commissioner
Margaret Jenniges	Financial Reporting Director

Chapter 1. Introduction

The Department of Finance manages the state's accounting, budgetary, and debt management activities. It establishes policies and procedures to ensure consistent and reliable financial data and compliance with statutory provisions. The Commissioner of Finance, appointed by the Governor, directs the department's operations. After Laura King's resignation in October 1996, Wayne Simoneau was appointed commissioner.

The department maintains the state's accounting system. Beginning in April 1995, the state implemented a new accounting and procurement system, Minnesota Accounting and Procurement System (MAPS), and a new human resource and payroll system, the Minnesota Statewide Employee Management System (SEMA4). The Departments of Finance, Administration, and Employee Relations jointly administer and maintain the new statewide business systems. In September 1996, the Financial Audit Division issued audit report No. 96-39 which focused on the integrity of financial data in the new statewide computer systems. In addition, the Program Evaluation Division of our office reviewed the costs and benefits of the new systems in a report issued on February 6, 1997.

Our work in the Department of Finance is completed as part of our annual Statewide Audit. As further discussed in Chapter 2, the primary objective of the Statewide Audit is to render an opinion on the state of Minnesota's financial statements. The Statewide Audit is also designed to meet the requirements of the Single Audit Act of 1984, relating to federal programs. The Single Audit Act requires us to review internal controls over federal financial assistance programs and to determine whether the state complied with rules and regulations material to each major federal program. The Financial and Compliance Report on Federally Assisted Programs will include our reports on a supplementary information schedule, the internal control structure, and compliance with laws and regulations. We anticipate issuing that report in June 1997.

Our audit scope included the following program areas administered by the Department of Finance that were material to the state's financial statements or to our Single Audit objectives in fiscal year 1996:

- general obligation bond sales;
- debt service transfers;
- master lease program;
- school energy loans;
- appropriation transfers to the University of Minnesota;
- federal cash management; and
- statewide indirect costs.

Department of Finance

Also, the Department of Finance, in conjunction with other state agencies, provided centralized statewide controls in the following areas:

- general ledger accounting;
- budgets and appropriations;
- cash receipts and disbursements;
- payroll transaction processing; and
- investment transaction and income accounting.

As part of our audit, we also reviewed selected controls over these areas in the Department of Finance and in other state agencies.

Chapter 2. External Financial Reporting

Chapter Conclusions

We issued an unqualified audit opinion on the state of Minnesota's fiscal year 1996 financial statements included in the Department of Finance's Comprehensive Annual Financial Report. However, the department faced many challenges in preparing and issuing the report in a timely manner. Financial statement preparers had to gain a complete understanding of the flow of transactions in the new system. Because the new system was not designed to readily accumulate financial information on a generally accepted accounting principles basis, additional analyses and review were necessary. Significant audit adjustments were necessary to correct preliminary financial statements. The department must make various changes in its procedures to improve the external financial reporting process in the future.

The Department of Finance prepares a Comprehensive Annual Financial Report that contains financial statements for the state of Minnesota. The report is prepared in accordance with generally accepted accounting principles for governmental units, as promulgated by the Governmental Accounting Standards Board . The Department of Finance is ultimately responsible for the accuracy, fairness, and completeness of the report. However, other state agencies prepare some of the individual fund financial statements. Governmental entities prepare financial statements using fund accounting. Table 2-1 shows the number of primary government funds and component units included in the state of Minnesota's reporting entity for fiscal year 1996.

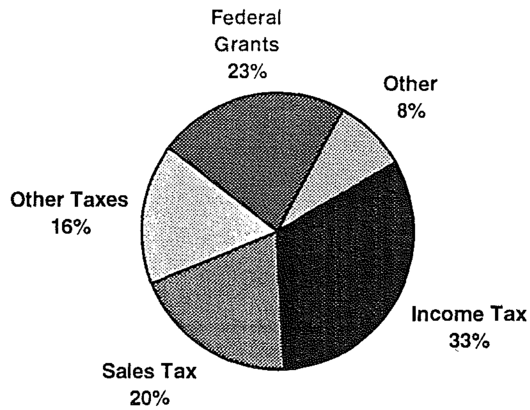
Table 2-1
State of Minnesota's Reporting Entity
Fiscal Year 1996

Classification	Number
Primary Government:	
Governmental Funds account for most traditional governmental activities.	20
Proprietary Funds account for an entity's business type activities.	16
Fiduciary Funds account for assets held in a trust or agency capacity.	26
Account Groups record governmental fund fixed assets and long term liabilities.	2
Component Units are legally separate entities financially accountable to the state.	11
Total	75

Source: State of Minnesota Fiscal Year 1996 Comprehensive Annual Financial Report

Governmental funds include the General, Special Revenue, Capital Projects, and Debt Service Funds. Their activity is financed primarily from tax revenue, as shown in Figure 2-1. Governmental fund revenue totaled $14.8 billion in fiscal year 1996.

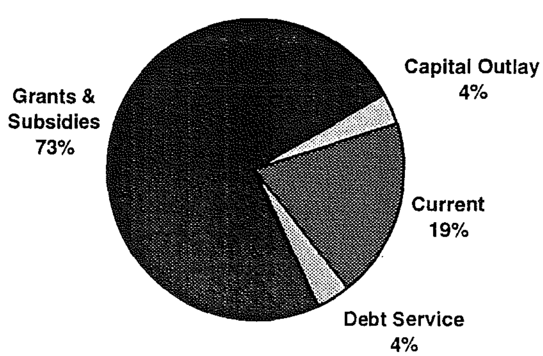
Figure 2-1
Governmental Funds
Fiscal Year 1996 Revenue



Source: State of Minnesota Fiscal Year 1996 Comprehensive Annual Financial Report.

The majority of governmental fund expenditures are for grant and subsidy payments to individuals, component units or other levels of government, as shown in Figure 2-2. Expenditures and component unit transfers totaled $14.5 billion in fiscal year 1996.

Figure 2-2
Governmental Funds
Fiscal Year 1996 Expenditures



Source: State of Minnesota Fiscal Year 1996 Comprehensive Annual Financial Report.

The Department of Finance maintains the MAPS general ledger. The general ledger and its supporting records provide the starting point for financial statement preparation. The department has implemented various control procedures to ensure the integrity of transactions recorded in the accounting system. The Department of Finance processes certain transactions, verifies supporting documentation before authorizing other transactions, and is responsible to ensure that transactions recorded on the accounting system reconcile to the actual transactions processed through the state's bank accounts.

Audit Objectives and Methodology

The objective of our work in the Department of Finance was to address the following questions:

- Did the state of Minnesota's fiscal year 1996 financial statements and supporting schedules comply with generally accepted accounting principles?

- Did the Department of Finance design internal controls to provide reasonable assurance that transactions recorded on the state's accounting system were accurate and complete?

Our objective included determining whether the financial statements included in the state of Minnesota's Comprehensive Annual Financial Report presented fairly the state's financial position, results of operations, and changes in cash flows in accordance with generally accepted accounting principles. We also determined whether the supporting schedules in the Comparison of Budget and Actual Revenues, Expenditures, and Changes in Fund Balance were fairly presented in relation to the Comprehensive Annual Financial Report's financial statements. As part of our work, we gained an understanding of internal control and determined whether the state of Minnesota complied with laws and regulations that have a material effect on its financial statements.

To meet our objectives, we interviewed agency staff to gain an understanding of internal controls and how the Department of Finance prepared the state's financial statements for fiscal year 1996. We also reviewed supporting documentation for financial statement amounts in the Department of Finance, as well as in other state agencies. We tested samples of detailed transactions and performed analytical procedures, as determined appropriate.

Conclusions

We issued unqualified audit opinions on the state of Minnesota's fiscal year 1996 financial statements and supporting schedules prepared by the Department of Finance. However, the department faced many challenges in preparing and issuing accurate financial statements in a timely manner. Financial statement preparers had to gain a complete understanding of the flow of transactions in the new system. Because the new system was not designed to readily accumulate financial information on a generally accepted accounting principles basis, additional analyses and review were necessary.

As discussed in our September 1996 report on MAPS and SEMA4, the Department of Finance did not design and implement certain control procedures in a timely manner. Necessary reconciliations of MAPS balances to external records were several months late. As a result, the accounting system contained erroneous information throughout fiscal year 1996. The department eventually corrected the erroneous information. However, because reconciliations were not performed timely, the department had to perform extensive review and analysis to identify the correcting entries.

Significant audit adjustments were necessary to correct preliminary financial statements. The department must make various changes in its procedures to improve the external financial reporting process, as discussed in Findings 1 through 6.

1. The Department of Finance did not have an effective process to identify and accumulate accrued liabilities at fiscal year end.

We made significant audit adjustments to the preliminary financial statements prepared by the Department of Finance because year end accrued liabilities were understated. Adjustments were necessary because state agencies erroneously recorded some transaction information in MAPS, and the Department of Finance incorrectly calculated some accounts payable amounts. For example, audit adjustments for understated liabilities totaled $152 million in the General Fund. Additional audit adjustments were necessary for the other funds.

The Department of Finance historically has identified a significant portion of accrued liabilities from a review of payments made after June 30 and before the close of books in September. In the old statewide accounting system, agencies recorded an occurrence date when making payments, and that date was the basis for liability recognition. Other payables were recognized based on a review of encumbrances outstanding at the close of books. With the advent of MAPS in fiscal year 1996, procedures changed. Finance expected state agencies to use the record date field when making payments to identify the date goods or services were received, which is the basis for expenditure and liability recognition. The Department of Finance then summarized all payments with a record date prior to June 30 and recorded the accumulated amounts as accounts payable. Finance also tested supporting documentation for payments with a record date after June 30 to identify additional liabilities.

There were various problems with the Department of Finance's approach to liability recognition in fiscal year 1996. The major problem resulted from improper use of the record date field. State agencies often did not enter the liability date when making payments. When a date was not entered, the record date defaulted to the current transaction date. In addition, payments that were entered through interface transactions were grouped together and entered with a current record date, even though they may have had different liability dates.

We noted significant record date problems with payments made by the Departments of Finance, Children, Families & Learning, Human Services, and Administration. Many of the problems occurred because the Department of Finance did not provide timely and well-understood guidance to state agencies on the use of record date to identify accrued liabilities. In addition, the department did not have an appropriate process for identifying liability date for those payments that were entered in MAPS through interface transactions.

We also found problems with the Department of Finance's review of after record date transactions. The department limited its review to selected expenditure categories. As a result, it did not identify $55 million in accrued liabilities for employee salaries. In addition, the department made several errors when reviewing individual payment transactions. For example, we tested 96 invoices that the Department of Finance reviewed and found calculation errors for 21 of the items tested. As a result of these errors, we made accounts payable audit adjustments totaling $1.2 million. Adjustments were necessary, in part, because the department did not properly prorate the liability amount between fiscal years and because of errors in the calculation of retainage amounts.

Recommendation

- *The Department of Finance should redesign its approach to identification of accrued liabilities so that expenditure recognition is based on the receipt of goods or services. Specifically, the department should:*
  - -- *work with state agencies to ensure a proper record date;*
  - -- *develop a process to identify accrued liabilities for interface transactions; and*
  - -- *establish appropriate guidelines for testing payment transactions.*

2. The Department of Finance's procedures for accumulating the state's accrued compensated absence liability resulted in erroneous reporting in its preliminary financial statements.

The Department of Finance's computerized program for accumulating compensated absence liabilities from the state payroll system (SEMA4) had certain logic errors that affected the accuracy of the department's year-end calculation. In addition, the department did not effectively coordinate reporting of compensated absence liabilities for employees whose leave balances were not recorded on SEMA4.

Governmental Accounting Standards Board Statement 16 establishes the requirements for reporting compensated absence liabilities in the state's annual financial statements. Within certain parameters, an entity is required to recognize an accrued liability for amounts employees have earned to date for accumulated vacation leave, compensatory time, and sick leave. The state's accrued liability at June 30, 1996, totaled $247 million.

SEMA4 accumulates leave balances for most state employees. Leave earned is automatically updated based on system accrual tables. Agencies post leave taken each pay period from employee timesheets. At the end of the year, the Department of Finance captures leave balances and pay rates from SEMA4. There were certain logic errors in the computer program that accumulated these balances for fiscal year 1996, including:

- certain positions funded from multiple accounts were incorrectly prorated or did not total 100 percent, resulting in a liability understatement of $6.7 million;

- some hourly leave balances were multiplied by biweekly salary rates, resulting in a liability overstatement of $1.5 million; and

- supplemental lump-sum pay for part-time positions distorted an agency's accumulated liability and overstated the state's total liability by $460,000.

In addition, the Department of Finance did not have an effective process to accumulate compensated absence liabilities for Minnesota State Colleges and Universities (MnSCU) employees whose leave balances were not recorded on SEMA4. The sick leave balances for community colleges and technical colleges, estimated at $24 million, are maintained at the individual institutions, rather than on the centralized system. The Department of Finance and MnSCU did not establish an appropriate process to accumulate this information in a timely manner. As a result, the department used estimates based on prior year balances for financial reporting purposes.

Recommendations

- *The Department of Finance should modify its compensated absence computer program to ensure proper calculations and allocations to accounts.*

- *The department should work with MnSCU to ensure proper accumulation and reporting of compensated absence balances for employees whose leave is not recorded on SEMA4.*

3. The Department of Finance needs to improve controls over loan receivable accounting.

The Department of Finance did not reconcile loan receivable balances on a timely basis. The department did not begin to reconcile fiscal year 1996 loan receivable balances until April 1996. As a result, the accounting system did not accurately reflect loan balances during most of the fiscal year. Various state agencies administer loan programs. The agencies record loan disbursements and loan repayments on MAPS. The Department of Finance generates a monthly loan report from the accounting system to determine if agencies properly recorded all loan transactions on the general ledger. The department prepares journal vouchers to post any transactions that agencies did not record correctly. The department performs a reconciliation of the general ledger loans receivable balance to detailed loan transactions recorded on MAPS. The June 30, 1996, loan receivable balance for all funds approximated $500 million.

The department had to prepare several journal vouchers in a short period of time to update the loan balances on the general ledger. The limited amount of time and the large number of journal vouchers caused some errors to occur. The department posted some journal vouchers to fiscal year 1997 in error. As a result, the fiscal year 1996 loan receivable balance was misstated. The department tried several different entries to correct the balances.

We noted other examples of problems in recording loan transactions. The department did not post $113,288 of loan repayments to the loan receivable balance on the general ledger. This occurred because the February 1996 loan report did not include loan repayment transactions that occurred during the first week of the month. Also, the department posted some loan disbursements to the incorrect loan program. A journal voucher prepared for January 1996 loan disbursements posted all of the Rural Finance Authority loans to the general ledger account for the beginning farmer loan program. However, $100,000 of the new loans disbursed that month were for the restructure loan program.

Recommendation

- *The Department of Finance should reconcile loan receivable balances and prepare correcting journal vouchers on a monthly basis.*

4. Deputy registrar receipts are not invested timely.

The process used to record deputy registrar receipts in the State Treasury includes unnecessary delays and does not result in a timely investment of funds. The deputy registrars collected approximately $770 million in tax revenue during fiscal year 1996. They deposit receipt collections in non-interest bearing local depository accounts. After they make the deposit, the deputy registrars mail a notification to the Office of the State Treasurer. Each day, the State Treasurer transmits the deposit documents to the Department of Finance, which subsequently records the transactions in MAPS. At times during fiscal year 1996, Finance did not record the transactions on a daily basis. The State Treasurer's depository accounting system receives daily electronic updates of all receipt transactions recorded in MAPS. Based on the MAPS information, the State Treasurer transfers the monies out of the local bank accounts into the state's general account, and the funds are available for investment.

Of the 36 receipt transactions we tested, 27 were recorded by the State Treasurer more than three days after the deputy registrars deposited the funds in local accounts. Delays ranged from 4 to 12 days because the State Treasurer could not withdraw these monies until Finance recorded them in MAPS. Assuming this pattern continues, we conservatively estimate an annual investment income loss of approximately $800,000 because of delays in recording deputy registrar receipts.

The Department of Finance, Office of the State Treasurer, and the Department of Public Safety, which is administratively responsible for the deputy registrars, all have a role in ensuring the timely deposit of these revenues. We believe that with available technology, the three agencies should be able to record this revenue and transfer deputy registrar receipts to investment accounts in a more timely manner.

Recommendation

- *The Department of Finance should work with the Office of the State Treasurer and the Department of Public Safety to improve the process for deposit of deputy registrar receipts to ensure monies are invested in a timely manner.*

Department of Finance

5. The Department of Finance has not appropriately identified all interfund transfer activity.

The Department of Finance is not appropriately recording all interfund transfers in the accounting system. As a result, financial statement adjustments were necessary to properly report this financial activity. In some cases, the department used journal vouchers to move cash between funds. The journal vouchers were not identified as transfer transactions. As an example, for fiscal year 1996, the department transferred $6 million in available monies to the Environment and Natural Resources Trust Fund by recording a journal voucher that increased cash and fund balance. As a result, the legally authorized transfer was not shown in the operating statements for the affected funds. Also, there was not an appropriate audit trail for the financial activity.

Recommendation

- *The Department of Finance should provide adequate documentation to identify all transfers between funds.*

Chapter 3. Debt Administration

Chapter Conclusions

The Department of Finance designed internal controls over debt transactions to provide reasonable assurance that amounts are authorized and accurately reported in the annual financial statements. The department complied with statutory provisions tested for the sale of $439,625,000 in general obligation bonds and $200,000,000 in state revenue bonds. The department appropriately transferred $277,522,000 to the Debt Service Fund for future debt redemption in accordance with constitutional and statutory provisions. In addition, for the items tested, the department complied with master lease statutory and contract provisions.

The cash and debt management division coordinates the sale of state general obligation bonds, used mainly to finance state building construction and repair. Various statutory provisions authorize the sale of bonds. In fiscal year 1996, the Department of Finance issued $439,625,000 in general obligation bonds for capital related projects. In addition, the department issued $200,000,000 in state revenue bonds to satisfy claims and judgments resulting from litigation regarding bank taxes. The revenue bonds are secured by the pledge of specified dedicated revenue including medical payments, license fees, lottery revenue, and other departmental earnings.

The division also calculates constitutionally and statutorally required transfers to the Debt Service Fund to accumulate funds for repayment of the general obligation bonds. Various legal provisions require that on November 1 or December 1 each year, the Commissioner of Finance shall transfer sufficient monies that, together with the balance on hand, will be sufficient to pay all principal and interest due through July 1 of the second ensuing year. Table 3-1 shows the funding sources for operating transfers to the Debt Service Fund in fiscal year 1996.

Table 3-1
Operating Transfers to the Debt Service Fund
Fiscal Year 1996

Transferred From	Amount
Primary Government:	
General Fund	$237,313,000
Trunk Highway Fund	11,626,000
Maximum Effort School Loan Fund	10,175,000
Building Fund	8,400,000
Other Funds	1,707,000
Component Units	8,301,000
Total	$277,522,000

Source: State of Minnesota Fiscal Year 1996 Comprehensive Annual Financial Report.

The cash and debt management division also administers the master lease program, which consolidates lease purchases. The objective of the program is to achieve more favorable financing than possible through individual arrangements. Minnesota statutes authorize the commissioners of Administration and Finance to determine the equipment needs of state agencies that can be economically funded through a master lease program. The Department of Administration uses the master lease program to purchase fixed assets, such as computer equipment and automobiles, for its Internal Service Funds. Except for the Department of Administration, eligibility for the program is limited to equipment with a capital value of more than $100,000 and a useful life of more than 10 years and equipment already purchased under existing lease/purchase agreements. Master lease drawdowns in fiscal year 1996 totaled $16 million.

Audit Objectives and Methodology

Our review of debt administration in the Department of Finance focused on the following objectives:

- Did the Department of Finance design internal controls to provide reasonable assurance that general obligation and state revenue bond sales and debt service transfers were authorized and accurately reported in the state's annual financial statements?

- Did the department comply with applicable constitutional and statutory provisions for the sale of general obligation and state revenue bonds and for required reserves on deposit in the Debt Service Fund?

- Did the department design internal controls to provide reasonable assurance that master lease debt transactions were properly authorized, accurately reported in the state's annual financial statements, and in compliance with applicable legal provisions?

Department of Finance

We gained an understanding of applicable policies and procedures relating to debt administration and tested compliance with statutory provisions regarding general obligation and state revenue bond sales. We also verified compliance with constitutional and statutory provisions governing required transfers to the Debt Service Fund. We reconciled master lease receipts and disbursements to related maturity schedules and tested to determine if master lease purchases complied with applicable statutory provisions and with the master equipment lease purchase agreement. We also reviewed Internal Service Fund master lease principal and interest repayments for propriety.

Conclusions

The Department of Finance designed internal controls over debt transactions to provide reasonable assurance that amounts are authorized and accurately reported in the annual financial statements. General obligation bond sales of $439,625,000 and state revenue bond sales of $200,000,000 complied with statutory provisions tested. The department appropriately transferred $277,522,000 to the Debt Service Fund in compliance with applicable constitutional and statutory provisions for debt reserves. In addition, for the items tested, the department complied with master lease statutory and contract provisions.

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Chapter 4. Administration of State and Federal Programs

Chapter Conclusions

The school energy loan balance and appropriation transfers to the University of Minnesota were fairly stated in the state's annual financial statements. The department's internal controls provided reasonable assurance that transactions for the two programs were properly recorded. Transfers to the University of Minnesota complied with applicable appropriation laws and payment formulas established in statute. However, the department did not have an appropriate process to assure that required match had been provided before payments were made to the University. Finally, the department complied with Single Audit requirements related to federal cash management and indirect cost recoveries.

In accordance with legal provisions, the Department of Finance administers selected state programs and is responsible to distribute state appropriations to component units and certain quasi-governmental entities. Our audit focused on those programs that were material to the state's financial statements in fiscal year 1996, including the school energy loan program and appropriation transfers to component units. The department also provides various centralized controls relating to the administration of federal financial assistance programs including federal cash management and statewide indirect costs. We discuss our review of these areas in the next sections.

School Energy Loan Program

In conjunction with the Department of Public Service, the Department of Finance administers the school energy loan program. School energy loans are made primarily to school districts, although some of the loans are to municipalities and other local governments. The loans are for energy related improvements to existing buildings. The program is funded from bond proceeds in the Building Fund and federal oil overcharge monies in the Federal Fund.

School districts and municipalities apply to the Department of Public Service for the loans. That department negotiates the loan agreements and determines the loan amount. The Department of Finance is responsible for disbursing the loan proceeds and depositing loan repayments. Table 3-1 shows the status of the Building Fund loans in fiscal year 1996.

Table 4-1
Building Fund
School Energy Loans Receivable
Fiscal Year 1996 Activity

	Amount
Loan Balance, July 1, 1995	$8,770,761
New Loans Issued	2,559,900
Loan Repayments	(1,991,494)
Loan Balance, June 30, 1996	$9,338,739

Source: State of Minnesota Fiscal Year 1996 Comprehensive Annual Financial Report and Department of Finance supporting schedules.

Audit Objectives and Methodology

Our review of the school energy loan program focused on the Building Fund financial activity and included the following objective:

- Did the Department of Finance design internal controls to provide reasonable assurance that school energy loans were properly recorded and fairly presented in the state's annual financial statements?

We interviewed departmental staff to gain an understanding of the process for disbursing loan payments and collecting repayments. We reviewed supporting documentation for amounts recorded in the accounting system and financial statements. In addition, we tested loan payments to verify that they were for energy conservation purposes and were supported by approved loan agreements.

Conclusions

The Building Fund school energy loan balance was accurately reported in the state's annual financial statements. The department's internal controls provide reasonable assurance that school energy loans were properly recorded.

University of Minnesota Transfers

The Department of Finance is responsible for transferring funds appropriated by the Legislature to the University of Minnesota, a component unit of the state. The university certifies that its cash balance in certain accounts is below an amount set in statute and requests payment of funds appropriated. The Department of Finance reviews the request for funds and the information provided by the university and then processes the payment. Monthly payments from the General Fund and various Special Revenue Funds are 1/12th of the appropriated amount. The department makes payments from the Building Fund based on the amount requested. Table 3-1 shows the funding source for transfers to the University of Minnesota in fiscal year 1996.

Table 4-2
Transfers to the University of Minnesota
Fiscal Year 1996

Fund	Amount
General	$483,860,000
Building	38,321,033
Health Care Access	2,442,000
Minnesota Resources	1,030,000
Workers' Compensation Special Payment	200,000
Total	$525,853,033

Source: State of Minnesota Fiscal Year 1996 Comprehensive Annual Financial Report.

Audit Objectives and Methodology

Our review of transfers to the University of Minnesota included the following objectives:

- Did the Department of Finance design internal controls to provide reasonable assurance that transfers to the University of Minnesota were properly disbursed and fairly presented in the state's annual financial statements?

- Did appropriation transfers to the University of Minnesota comply with applicable appropriation laws and payment formulas established in statute?

We interviewed departmental staff to gain an understanding of the process for payment of appropriations to the University of Minnesota. We traced amounts to applicable appropriation laws and reviewed supporting documentation for amounts recorded in the accounting system and financial statements.

Conclusions

Transfers to the University of Minnesota were fairly presented in the state's annual financial statements. Payments complied with appropriation laws and formulas established in statute. The Department of Finance generally designed internal controls to provide reasonable assurance that appropriation transfers were properly disbursed. However, the department did not have an appropriate process to assure that required match had been provided before payments were made to the university, as discussed in Finding 6.

6. The Department of Finance needs to improve controls over payment of appropriations requiring matching funds.

The Department of Finance does not have a process in place to assure that any required match will be provided before making appropriation transfers. The department did not obtain documentation of matching funds from the University of Minnesota before transferring amounts appropriated from the Minnesota Resources Fund. Laws of 1995, Chapter 220, Section 19, subd. 6(q) appropriated $350,000 to the university to establish a chair in forest wildlife research and education. Subd. 8(h) of the same law appropriated $680,000 for arboretum land acquisition. The appropriation for a forest wildlife chair states that the University must provide $350,000 of nonstate matching funds. The appropriation for arboretum land acquisition requires a nonstate match of $400,000. The Department of Finance paid the total of these appropriations without receiving documentation that the university had met the matching requirement.

In September 1996, following our inquiries, the department requested documentation for the match from the university. The supporting documentation provided for the wildlife chair appropriation shows cash and pledges totaling $350,000 as of December 31, 1995. The documentation for the land acquisition appropriation totaled $410,000. However, pledges for at least $25,000 of the $410,000 were received in June and July of 1996. One of the land acquisition pledges provided for payment over a four-year period ending in 1999.

In addition, Laws of 1995, Chapter 234, Article 11, subd. 4, appropriated $125,000 for a primary care training initiative only if the university provided evidence of matching funds. The university never provided any documentation of matching monies. However, the Department of Finance included the $125,000 appropriation when making monthly payments from the Health Care Access Fund. Before the end of the year, the department noticed that the university had not met the matching requirements and adjusted subsequent payments to recover amounts paid from the $125,000.

Recommendation

- *The Department of Finance should verify that the University of Minnesota has met matching requirements before making appropriation transfers.*

Federal Cash Management

The Department of Finance is responsible for overseeing the state's compliance with the Cash Management Improvement Act (CMIA) of 1990. Congress enacted the CMIA to ensure efficiency, effectiveness, and equity in the transfer of federal funds between state agencies and the federal government. The primary goal of the CMIA is to minimize the time elapsing between the transfer of funds from the U.S. Treasury and the disbursement of funds for program purposes by a state. The CMIA also specifies approved methods states may use to draw federal funds and addresses the calculation of interest liabilities. The state entered into an agreement with the U.S. Department of Treasury (the Treasury-State Agreement), which specifies procedures for implementing the CMIA. The CMIA became effective for the state of Minnesota on July 1, 1993.

State agencies track the date they requested federal funds, the date they expected to receive federal funds based on the average clearance day, and the date they actually received the federal funds. At the end of the fiscal year, agencies calculate any interest liabilities and report them to the Department of Finance. Using this data, the department prepares an annual report and submits it to the federal government. For fiscal year 1996, the state's interest liability to the federal government totaled $39,172, while the federal liability to the state totaled $90,881 for interest plus $5,452 for the cost of implementing the act.

Audit Objectives and Methodology

Our review of federal cash management is designed to satisfy the requirements of the Single Audit Act. It focused on the following objectives:

- Did the Department of Finance design internal controls to provide reasonable assurance that it complied with applicable federal laws and regulations relating to federal cash management?

- Did the department calculate federal and state interest liabilities in compliance with the Treasury-State agreement and federal regulations?

We interviewed staff to gain an understanding of how the department prepared the annual federal cash management report and calculated interest liabilities. We reviewed the documentation submitted by state agencies and determined if the liability calculations complied with the Treasury-State agreement and federal regulations. We reviewed the report prepared by the Department of Finance and determined if it was accurate, based on information from state agencies, and if the department submitted it timely.

We review state agency compliance with CMIA provisions in our annual audits of major federal programs. In our review of federal cash management procedures at the Department of Human Services for fiscal year 1996, we found that the department was not drawing federal funds in a timely manner. We estimate that the state lost investment income of approximately $3 million in fiscal year 1996 as a result of the poor cash management practices. The Department of Finance should work with the Department of Human Services to ensure compliance with the Treasury-State agreement. The Department of Finance should also investigate the possibility of recovering the lost investment income from the federal government.

Conclusions

The Department of Finance designed internal controls to provide reasonable assurance that it complied with applicable federal laws and regulations relating to federal cash management. For the items tested, the fiscal year 1996 interest liability calculations complied with the Treasury-State agreement and applicable federal regulations.

Statewide Indirect Costs

In accordance with Minn. Stat. Section 16A.127, the Department of Finance prepares an annual statewide indirect cost plan. The plan is designed to allocate the cost of general support services, originally paid by the General Fund, to other eligible funding sources. The plan is submitted to the federal Department of Health and Human Services for approval. Office of Management and Budget (OMB) Circular A-87 sets the criteria for allowable costs and cost principles to charge federal programs. Unless indirect cost recoveries are specifically appropriated in law, agencies are required to reimburse the General Fund for the portion of statewide indirect costs recovered from other funding sources. The budget services division of the Department of Finance prepares the statewide indirect cost plan and monitors receipt of recoveries. For fiscal year 1996, agencies reimbursed $12.6 million to the General Fund for statewide indirect costs.

Audit Objectives and Methodology

Our review of indirect cost recoveries is designed to satisfy the requirements of the Single Audit Act. It focused on the following objectives:

- Did the Department of Finance design internal controls to provide reasonable assurance that indirect cost billings were accurate and in compliance with applicable federal and state laws and regulations?

- Did the Department of Finance comply with applicable federal laws and regulations relating to indirect cost recoveries from federal financial assistance programs?

We interviewed departmental staff to gain an understanding of the process used to develop the statewide indirect cost plan. We reviewed the plan that the Department of Health and Human Service had approved. We tested the costs included in the plan to determine if they complied with federal cost principles. We also traced a sample of costs included in the plan to supporting documentation.

Conclusions

The Department of Finance designed internal controls to provide reasonable assurance that indirect cost billings complied with applicable federal and state laws and regulations. For the items tested, the Department of Finance complied with federal regulations governing indirect cost recoveries.

State of Minnesota
Department of Finance

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March 11, 1997

James R. Nobles
Legislative Auditor
Office of the Legislative Auditor
658 Cedar Street
St. Paul, MN 55155

Dear Mr. Nobles:

Thank you for the opportunity to discuss these findings with the staff in your office responsible for the Department of Finance audit.

As you stated in this report, the department did face many challenges in preparing and issuing the Comprehensive Annual Financial Report in a timely manner. It is to the credit of the staff of the Department of Finance, the Legislative Auditor's Office and many state agencies that this was accomplished. Both the financial statement preparers and the auditors had to gain an understanding of the flow of transactions in the new accounting systems. In addition, we verified the integrity of the information in the system.

We realize that everything was not done according to our usual high standards. However, given the magnitude of the project, we are proud of our accomplishments. Our goal now is to make the necessary improvements, including those noted in the report, so that we provide accurate and timely financial information.

Recommendation

The Department of Finance should redesign its approach to identification of accrued liabilities so that expenditure recognition is based on the receipt of goods or services. Specifically, the department should:

- work with state agencies to ensure a proper record date;
- develop a process to identify accrued liabilities for interface transactions; and
- establish appropriate guidelines for testing payment transactions.

Response

The department recognizes that the information provided agencies on the correct use of the various date fields in MAPS was often confusing. This led to the use of inappropriate dates in the date of record field.

We are preparing a memo explaining the correct date to be placed in each date field for the various document types used in MAPS. This document will address only the date fields and will be distributed to all state agencies in March. In addition, a session at the annual accounting seminar will include a discussion of the proper use of the various date fields. We are also planning to distribute a job aid for accounting staff to refer to when determining the proper date for each date field.

The financial reporting unit is developing detailed procedures that will be followed when selecting and testing payment transactions for liability recognition. The procedures will include the methods for identifying liabilities for interface transactions and for the calculation of retainage. These procedures will be followed when testing the fiscal year 1997 accrued liabilities.

Recommendation

The Department of Finance should modify its compensated absence computer program to ensure proper calculations and allocations to accounts.

Response

We have modified the compensated absence computer program to correct the logic errors. The program is in the process of being tested to ensure that the calculation is done correctly for fiscal year 1997.

Recommendation

The department should work with MnSCU to ensure proper accumulation and reporting of compensated absence balances for employees whose leave is not recorded on SEMA4.

Response

It should be noted that it was never the intention that SEMA4 would handle all MnSCU leave. The MnSCU payroll system has a leave accrual component. All of the campuses have been instructed by the MnSCU central office to use the leave accrual component. The central office will be working with the campuses to ensure that the leave is properly recorded. We will work with MnSCU to monitor the progress and ensure that the campuses are using the system.

Recommendation

The Department of Finance should reconcile loan receivable balances and prepare correcting journal vouchers on a monthly basis.

Response

We realize that several errors were made when recording and correcting loan repayment transactions, and that the reconciliations were not done timely. Loan reconciliations are now current and the correcting journal vouchers are now made immediately after each monthly reconciliation is completed. Also, a statewide policy explaining the correct method for processing loan repayments will be issued in April. After the agencies implement the policy, the reconciliation process will be faster and require fewer correcting entries.

Recommendation

The Department of Finance should work with the Office of the State Treasurer and the Department of Public Safety to improve the process for deposit of deputy registrar receipts to ensure monies are invested in a timely manner.

Response

There were two time periods during fiscal year 1996 when we did not record the deputy registrar transactions on a daily basis. All staff responsible for recording receipts have been instructed that recording receipts is their highest priority.

In addition, the Departments of Finance and Public Safety and the Office of the State Treasurer have been discussing possible methods to transfer receipt and deposit information from the deputy registrars to the three agencies. The Department of Public Safety is developing a proposal for electronically transmitting the information. The three agencies will continue to meet on a regular basis until the issue is resolved and a plan is in place. By July 1, 1997, we plan to have those deputy registrars collecting the largest amounts submit their receipt information electronically. We will then begin working with the rest of the deputy registrars to have them also submit their data electronically.

Recommendation

The Department of Finance should provide adequate documentation to identify all transfers between funds.

Response

In some instances, journal vouchers are used to move cash between funds at the fund level. This is an appropriate journal voucher transaction and the preferred method for this type of transfer. We are now coding the journal vouchers that are transfers so that they can be easily identified and reported properly.

Recommendation

The Department of Finance should verify that the University of Minnesota has met matching requirements before making appropriation transfers.

Response

We had a process in place for verifying that matching requirements are met. However, this process was not followed when duties were reassigned as a part of the implementation of MAPS. This process is again being followed. Formal procedures will be developed by the end of March to prevent this from occurring again.

Sincerely,

Wayne Simoneau

Wayne Simoneau
Commissioner