

State Agricultural Society

Financial Audit

For the Year Ended October 31, 1996

March 1997

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Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

97-16



STATE OF MINNESOTA

OFFICE OF THE LEGISLATIVE AUDITOR

CENTENNIAL BUILDING, 658 CEDAR STREET • ST. PAUL, MN 55155 • 612/296-4708 • TDD RELAY 612/297-5353

JAMES R. NOBLES, LEGISLATIVE AUDITOR

Members of the Legislative Audit Commission

Mr. Martin Annexstad, President
Board of Managers
State Agricultural Society

Members of the State Agricultural Society

Mr. Jerry Hammer, Executive Vice President
State Agricultural Society

We have audited the State Agricultural Society for the year ended October 31, 1996. The primary objective of our audit was to issue an opinion of the financial statements of the Society for the year then ended. The State Agricultural Society Annual Report for the year ended October 31, 1996 includes our opinion thereon dated February 19, 1997. The following Summary highlights the audit objectives and conclusions. We discuss our conclusions and concerns more fully in the body of this report.

We conducted our audit in accordance with generally accepted government auditing standards. As part of obtaining reasonable assurance about whether the Society's financial statements are free from material misstatement, we performed tests of the Society's compliance with certain provisions of laws, regulations, contracts, and grants. We also obtained an understanding of the Society's internal control structure. Our conclusions on compliance and internal control are included within this report as a *Report on Compliance Based on an Audit of Financial Statements* and an *Auditor's Report on the Internal Control Structure*.

This report is intended for the information of the Legislative Audit Commission and the management of the State Agricultural Society. This restriction is not intended to limit the distribution of this report, which was released as a public document on March 27, 1997.

James R. Nobles
Legislative Auditor

John Asmussen, CPA
Deputy Legislative Auditor

End of Fieldwork: February 19, 1997

Report Signed On: March 21, 1997

SUMMARY

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State Agricultural Society

Financial Audit

For the Year Ended October 31, 1996

Public Release Date: March 27, 1997

No. 97-16

Agency Background

The State Agricultural Society operates under Minn. Stat. Chapter 37. The Minnesota State Agricultural Society Board of Managers administers the operation of the annual State Fair exposition and the maintenance of the fairgrounds. Mr. Mike Heffron served as the executive vice president of the society until his retirement in January 1997. The board appointed Mr. Jerry Hammer as the new executive vice president on January 19, 1997.

Financial Highlights

At October 31, 1996, the State Agricultural Society reported net income of \$603,666. The society generated \$20,065,202 in revenues during the fiscal year, including both fair-time and non-fair event revenues. The society had total assets of \$21,405,878 as of October 31, 1996.

Objectives

The audit objectives were to:

- issue an audit opinion on the society's financial statements
- evaluate internal control structure of the society
- test compliance with significant finance-related legal provisions

Conclusions

We issued an unqualified opinion on the society's financial statements. We concluded that the financial statements were fairly stated in compliance with generally accepted accounting principles.

We found two issues affecting the society's internal control structure and its compliance with finance-related legal provisions:

- The society should improve controls over the revenue collected from the state fair's carnival ticket sales.
- The society did not account for the required match of foregone sales tax for capital improvements during fiscal year 1996.

State Agricultural Society

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Audit Participation

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

John Asmussen, CPA	Deputy Legislative Auditor
Jeanine Leifeld, CPA	Audit Manager
Charlie Gill	Auditor-in-Charge
Shane Smeby	Auditor
Anna Lamin	Auditor

Exit Conference

We discussed the results of the audit at an exit conference with the following staff of the State Agricultural Society on March 6, 1997:

Jerry Hammer	Executive Vice President
Marshall Jacobson	Finance Director

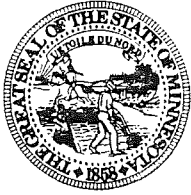
State Agricultural Society

Introduction

The State Agricultural Society was legally organized as a public corporation in 1860. The society operates under Minn. Stat. Chapter 37. However, it is a self-governing body and is exempt from the finance-related rules and regulations applicable to most state agencies.

The Minnesota State Agricultural Society Board of Managers administers the operation of the annual state fair exposition and the maintenance of the fairgrounds. The 10-member board is comprised of one representative from each of the society's nine regional districts and a president. Annually, the board elects an executive vice president for the society. Mr. Mike Heffron served as the executive vice president of the society until his retirement in January 1997. The board appointed Mr. Jerry Hammer as the new executive vice president on January 19, 1997.

The State Agricultural Society is financially self-sufficient. The society reported net income of \$603,666 for the year ended October 31, 1996, and \$1,559,641 for the year ended October 31, 1995. The society's primary sources of revenue are fair-time ticket sales and space rentals. Significant expense classifications include activities and support, plant maintenance, plant operations, administrative, and depreciation charges. The society generated \$20,065,202 in revenues during the fiscal year, including both fair-time and non-fair event revenues. The society had total assets of \$21,405,878 on October 31, 1996. The society's annual report, which includes its audited financial statements, is available upon request from the society.



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JAMES R. NOBLES, LEGISLATIVE AUDITOR

Auditor's Report on the Internal Control Structure

Mr. Martin Annexstad, President
Board of Managers
State Agricultural Society

Members of the State Agricultural Society

Mr. Jerry Hammer, Executive Vice President
State Agricultural Society

We have audited the financial statements of the State Agricultural Society, as of and for the year ended October 31, 1996, and have issued our report thereon dated February 19, 1997.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

The management of the State Agricultural Society is responsible for establishing and maintaining an internal control structure. 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, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations on any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the 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.

In planning and performing our audit of the financial statements of the State Agricultural Society for the year ended October 31, 1996, we obtained an understanding of the internal control structure. With respect to the internal control structure, 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 in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control structure. Accordingly, we do not express such an opinion.

Mr. Martin Annexstad, President
Members of the State Agricultural Society
Mr. Jerry Hammer, Executive Vice President
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We noted a matter discussed in Finding 1 involving the internal control structure and its operation that we consider to be a reportable condition 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 society's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

A material weakness is a reportable condition in which the design or operation of one or more 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 statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

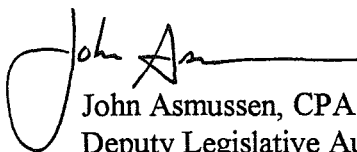
Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we do not believe that the reportable condition described above is a material weakness.

We also noted other matters involving the internal control structure and its operation that we reported orally to the management of the State Agricultural Society at an exit conference held on March 6, 1997.

This report is intended for the information of the State Agricultural Society management and the Legislative Audit Commission. However, this report is a matter of public record, and its distribution is not limited.



James R. Nobles
Legislative Auditor



John Asmussen, CPA
Deputy Legislative Auditor

February 19, 1997



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JAMES R. NOBLES, LEGISLATIVE AUDITOR

Report on Compliance Based on an Audit of Financial Statements

Mr. Martin Annexstad, President
Board of Managers
State Agricultural Society

Members of the State Agricultural Society

Mr. Jerry Hammer, Executive Vice President
State Agricultural Society

We have audited the financial statements of the State Agricultural Society, as of and for the year ended October 31, 1996, and have issued our report thereon dated February 19, 1997.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

Compliance with laws, regulations, contracts, and grants applicable to the State Agricultural Society is the responsibility of the society's management. As part of obtaining reasonable assurance about whether the financial statements are free from material misstatement, we performed tests of the society's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our audit of the financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests disclosed one instance of noncompliance, discussed in Finding 2, that is required to be reported herein under *Government Auditing Standards*.

This report is intended for the information of the State Agricultural Society management and the Legislative Audit Commission. However, this report is a matter of public record, and its distribution is not limited.

James R. Nobles
Legislative Auditor

John Asmussen, CPA
Deputy Legislative Auditor

February 19, 1997

Current Findings and Recommendations

1. PRIOR FINDING PARTIALLY RESOLVED: The State Agricultural Society did not adequately control receipts from the state fair's carnival ticket sales.

State Agricultural Society personnel did not adequately control carnival receipts. Employees did not always follow the control procedures put into place for the fair. As a result, the society was unable to account for \$41,355 out of about \$4.4 million in carnival receipts the society collected during the 1996 fair.

The 1996 State Fair was the second year carnival activities were managed by the society. The society took on this task to increase profits from carnival operations and to improve the appearance of the carnival area. In previous years, the society had contracted with a carnival vendor to organize the rides and games, sell tickets, and handle cash. The carnival contract had provided the society with a percentage of the ticket sales. The society is able to retain a larger percentage of the profits from the midway by managing the carnival area itself.

The society had been unable to account for \$41,983 of carnival receipts after the 1995 state fair. Based on that experience, the society made many changes to improve controls over the 1996 carnival. The society planned for higher ticket volume, built larger ticket booths, wrote new procedures, and provided training, all to provide better control over sellers, cash pick-up, and tickets.

However, once the fair began, fair personnel did not consistently follow control procedures. In some instances, supervisors did not accurately complete reconciliations and, because of this, booth totals could not be reconciled. The supervisor recorded unexplained differences into reconciliations without investigating the discrepancies. Midway vault activity sheets, which summarize each day's midway activity, were not completed. As a result, the society financial staff could not determine carnival ticket sales by daily sales amounts. By comparing ending carnival ticket inventories to total receipts, the society determined that it had a total shortage of \$41,355 for the 1996 carnival activity.

Recommendation

- *Society staff need to insure that fair personnel follow procedures put in place to provide adequate control over carnival ticket receipts.*

2. The State Agricultural Society did not account for the required match of foregone sales tax for capital improvements during fiscal year 1996.

For fiscal year 1996, the society has not demonstrated that it complied with the provisions of Minn. Stat. Section 297A.25, relating to foregone sales tax for capital improvements. The society

State Agricultural Society

did not transfer the required matching funds into its Building Fund. In addition, special assessments were not recorded in a way that identified matching funds for capital improvements in accordance with the statute.

Minn. Stat. Section 297A.25 Subd. 40 was passed in 1988. It allows the society to keep sales tax collected from ticket sales that would otherwise be paid to the Department of Revenue, provided that:

- (1) the tax foregone under this subdivision is used exclusively for the purpose of making capital improvements to state-owned buildings and facilities on the state fairgrounds; and
- (2) the tax foregone under this subdivision is matched in equal amount by proceeds from special assessments levied against commercial exhibits, concessions and rentals, and from other special user fees specifically designated for capital improvements.

The society spends substantial amounts each year for the maintenance and improvements of its buildings. In fiscal year 1996, the society spent over \$5 million from the its General Fund and Building Fund on capital improvements.

As in previous years, the society calculated its sales tax liability on ticket sales after the 1996 fair and transferred \$790,399 to the Building Fund. However, the society did not transfer a matching amount at that time. We believe the match should have been made in order for the society to expend the foregone sales tax amount.

In addition, the source of the matching funds is not clear. As stated above, the match is to come from special assessments levied against vendors at the fair. Currently, the society charges a variety of assessments to vendors. However, most of the assessments are not "specifically designated for capital improvements." Although the society records all assessment revenues in the General Fund, it has historically allocated some of these assessments to the Building Fund.

Recommendations

- *The society should transfer its matching funds into the Building Fund in order to expend the foregone sales tax.*
- *Whenever possible, the society should specifically cite a special assessment for capital improvements in its agreements with vendors and exhibitors.*



Ms. Jeanine Leifeld
Audit Manager
Minnesota Legislative Auditor
Centennial Building
658 Cedar Street
St. Paul, MN 55155

March 18, 1997

Dear Ms. Leifeld,

Response to finding number one

We share your concern regarding control of midway ticket receipts and are working diligently to resolve the situation. In 1995, our first year of operating the midway, we experienced shortages in receipts that were largely the result of three factors: volume and rate of cash activity, ticket booths located at great distances from each other and a group of inexperienced seasonal employees.

For '96, the system was redesigned to consolidate ticket sales facilities into several large multi-seller booths, improving our supervision capabilities and reconciliation procedures. Although shortages persisted in '96, we believe the centralized ticket sales system is sound. The system will improve through consistent application of control procedures and through development of a solid core of experienced staff.

Procedures will be implemented by the finance division (Marshall Jacobson) who will supervise ticket sales and cash management, and the sales division (Jim Sinclair) who will oversee ticket collections and contractor settlements.

Response to finding number two

One of the Society's foremost obligations is upkeep of the State Fairgrounds, its scores of structures and its extensive infrastructure. Minn. Stat. Section 297A.25 Subd. 40 is a key component in enabling the Society to meet this obligation. The Society exercises the utmost care to meet the requirements of the law and, in all respects, the Society has complied with the law.

When the Society building fund was established in 1988, a program of special assessments for capital projects was instituted with exhibitors and concessionaires. Each year since, including 1996, funds that equalled or exceeded the required match amount were raised through this assessment program and used for capital projects.

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Jeanine Leifeld, Minnesota Legislative Auditor
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During fiscal '96, capital projects undertaken by the Society greatly exceeded the combined total of foregone sales tax and capital project assessments. At the end of fiscal '96, working capital levels prohibited the Society from formally transferring matching funds raised through the assessment program to the Building Fund account. The transfer will be made in fiscal '97.

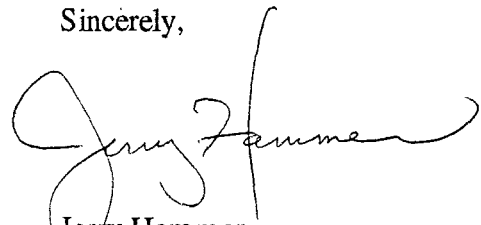
Beginning this year, when working capital levels are high, the Society will transfer to the building fund the foregone sales tax and special assessments match based on carefully estimated budget figures. When Society accounts are closed for the year and exact foregone sales tax and special assessment figures are available, adjustments will be made to the building fund, if necessary.

In addition, whenever possible, the Society will clearly designate the special assessments for capital improvements in its agreements with concessionaires and exhibitors.

Accounting procedures will be implemented by the finance division (Marshall Jacobson); language relating to special assessments for capital projects will be added to agreements whenever possible by the sales division (Jim Sinclair) and operations division (Ken Wenzel).

Our thanks to you and the audit team for your efforts and for your cooperation.

Sincerely,



Jerry Hammer
Executive Vice President