Department of Finance

Programs Selected For Fiscal Year 1997 Statewide Audit

March 1998

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Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

98-14

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STATE OF MINNESOTA
OFFICE OF THE LEGISLATIVE AUDITOR
JAMES R. NOBLES, LEGISLATIVE AUDITOR

Senator Deanna Wiener, Chair
Legislative Audit Commission

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, 1997, 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 1997 financial statements. The Comprehensive Annual Financial Report for the year ended June 30, 1997, includes our report, issued thereon, dated December 8, 1997. The Minnesota Financial and Compliance Report on Federally Assisted Programs for the year ended June 30, 1997, will include our reports on the supplementary information schedule, internal control structure, and compliance with laws and regulations. We anticipate issuing that report in March 1998. 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 6, 1998.

James R. Nobles
Legislative Auditor

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: January 23, 1998

Report Signed On: March 3, 1998

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SUMMARY

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Department of Finance

Programs Selected for Fiscal Year 1997 Statewide Audit

Public Release Date: March 6, 1998 No. 98-14

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. Wayne Simoneau was appointed commissioner in October 1996.

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 1997. 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 1997: 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.

We issued an unqualified opinion on the state's financial statements for fiscal year 1997. However, we concluded that the department should make various changes in its procedures to improve the external financial reporting process. This includes working with other state agencies to ensure that they understand applicable accounting principles and how to obtain accurate information for financial statement preparation. We also found that the department did not cancel outstanding warrants in accordance with statutory requirements. We also concluded that, for the items tested, the department complied with applicable legal requirements governing general obligation bond sales, debt service transfers, the master lease program, transfers to the University of Minnesota, federal cash management, and statewide indirect costs.

The department agreed with the audit report's findings and recommendations and is taking action to resolve the issues.

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Audit Participation

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

Claudia Gudvangen, CPA	Deputy Legislative Auditor
Tony Toscano	Auditor-in-Charge
Susan O'Connell	Auditor
Chege Ngigi	Auditor
Shane Smeby	Auditor
Rick Weinmeyer	Auditor
Terry Hanson	Auditor
Keith Bispala	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 February 24, 1998:

Wayne Simoneau	Commissioner
Rosalie Greeman	Assistant Commissioner
Margaret Jenniges	Director of Financial Reporting
Harley Will	Financial Reporting Supervisor

Chapter 1. Introduction

The Department of Finance maintains the state's accounting system and manages its 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. Wayne Simoneau was appointed commissioner in October of 1996.

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, as amended in 1996, 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 March 1998.

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 1997:

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

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.

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Chapter 2. External Financial Reporting

Chapter Conclusions

We issued an unqualified audit opinion on the state of Minnesota's fiscal year 1997 financial statements included in the Department of Finance's Comprehensive Annual Financial Report. We also concluded that the department designed internal controls to provide reasonable assurance that transactions recorded in the accounting system were accurate and complete. However, as discussed in our prior audit report, the department faced many challenges when converting accounting system data to financial statements prepared in accordance with generally accepted accounting principles (GAAP). The department made certain procedural changes during fiscal year 1997 to improve its processes. However, additional issues should be addressed to ensure timely and accurate financial reporting. In addition, the department did not comply with a statutory provision relating to timing of the cancellation of outstanding warrants.

The Department of Finance issues 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 entities, 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 1997.

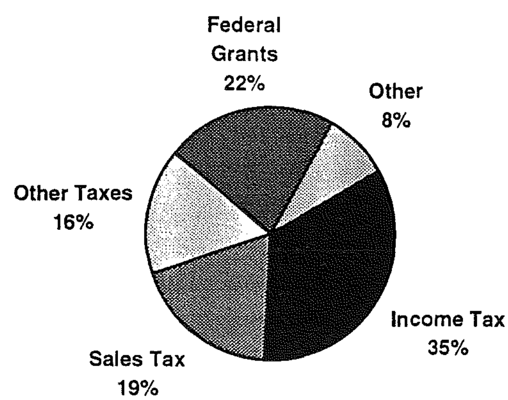
Table 2-1
State of Minnesota's Reporting Entity
Fiscal Year 1997

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 1997 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 $15.8 billion in fiscal year 1997.

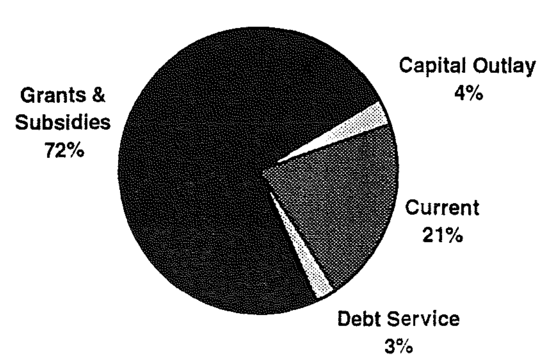
Figure 2-1
Governmental Funds
Fiscal Year 1997 Revenue



Source: State of Minnesota Fiscal Year 1997 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 $15 billion in fiscal year 1997.

Figure 2-2
Governmental Funds
Fiscal Year 1997 Expenditures



Source: State of Minnesota Fiscal Year 1997 Comprehensive Annual Financial Report.

Department of Finance

The Department of Finance maintains the Minnesota Accounting and Procurement System (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 and other state agencies was to address the following questions:

- Did the state of Minnesota's fiscal year 1997 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 compliance with generally accepted accounting principles. We also determined whether the supporting schedules were fairly presented in relation to the Comprehensive Annual Financial Report's financial statements. As part of our work in the Department of Finance and other state agencies, we gained an understanding of internal control and determined whether the state of Minnesota complied with laws and regulations that have a direct and material effect on its financial statements.

To meet our objectives, we interviewed agency staff to gain an understanding of the financial reporting process and the internal controls designed to ensure the accuracy of transactions recorded in the accounting system. 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. We also reviewed and tested various reconciliations and other supporting documentation for established control procedures.

Conclusions

We issued unqualified audit opinions on the state of Minnesota's fiscal year 1997 financial statements and supporting schedules prepared by the Department of Finance. We also concluded that the department designed internal controls to provide reasonable assurance that transactions recorded in the accounting system were accurate and complete. However, as discussed in our prior audit report, the department faced many challenges in converting accounting system data to financial statements prepared in accordance with generally accepted accounting principles (GAAP). With the implementation of a new accounting system in fiscal year 1996, Department of Finance, and other state agency, staff members had to become familiar with transaction processing and the accumulation of information. They also had to determine necessary adjustments to prepare financial statements in accordance with GAAP. The department made certain procedural changes during fiscal year 1997 to improve its processes. However, additional issues should be addressed to ensure timely and accurate financial reporting. These issues are discussed in Findings 1 and 2. Finding 3 discusses noncompliance with a statutory provision relating to outstanding warrants.

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

Year end accrued liabilities reported in the preliminary financial statements for fiscal year 1997 were significantly understated. For example, audit adjustments for understated expenditure accruals totaled $141 million in the General Fund. Audit adjustments were also necessary for other state funds. We identified a similar concern in our prior audit report.

Audit adjustments were necessary, in part, because state agencies, including the Department of Finance, identified an incorrect record date for various disbursement transactions. The record date should represent the date goods or services were received, which is the basis for expenditure and liability recognition. However, agencies sometimes entered the current date or the invoice date when making payments. In addition, payments that were entered through interface transactions were grouped together and identified with a current record date, even though they may have had different liability dates.

The Department of Finance provided state agencies with additional guidance on the use of record dates during fiscal year 1997. In addition, the department tested certain payment transactions to determine if the record date was correct. As a result, we saw some improvement in agency procedures. However, some problems still remain. The Department of Finance did not have an appropriate process for identifying liability date for those payments that were entered in MAPS through interface transactions. Also, in its testing of preliminary MAPS information, the department limited its review to selected expenditure categories. As a result, the department did not identify some significant additional liabilities, including $40 million in accrued payroll in the General Fund. In addition, the department did not clearly define its expectations when testing encumbrance balances at the close of books. As a result, departments certified incorrect liability amounts and adjustments were necessary. For example, we made an audit adjustment of $10 million in the Transportation Fund.

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 agency staff to ensure that record dates are accurate;*
  - *develop a process to identify accrued liabilities for interface transactions; and*
  - *establish appropriate guidelines for testing payment transactions.*

2. Some state agencies have not produced accurate and complete financial statement information in a timely manner.

The Department of Finance needs to work with various state agencies to ensure that they prepare accurate financial statements and supporting schedules in a timely manner. The department delegates financial statement responsibility for selected funds and activities to other state agencies. The Department of Finance must work with these agencies to ensure that staff members understand relevant accounting principles and how to prepare appropriate financial statements and schedules.

We identified problems with financial statement preparation in various agencies. In some cases, agency personnel did not understand the underlying principles related to financial statement preparation. In other instances, agencies did not have appropriate information to prepare the financial statements and schedules. Various delays in the process impeded the Department of Finance's ability to complete the financial reporting process within established time frames. The following examples highlight the problems encountered:

- The Department of Children, Families & Learning (CFL) did not appropriately estimate the allowance for uncollectible loans when preparing financial statements for the Maximum Effort School Loan Fund. The fund provides loans to school districts for capital projects and debt service. Statutory provisions allow for forgiveness of the loans after 50 years if the school districts cannot repay the loan principal and interest. At June 30, 1997, school districts owed the state approximately $181 million. However, subsequent analysis determined that loans totaling about S137 million most likely would not be repaid. CFL did not analyze the loans and establish an allowance for uncollectible accounts that accurately reflected the potential for future repayment. As a result, the loans receivable balance in the preliminary financial statements was overstated by $96 million. Subsequent adjustments were made to more accurately portray the financial status of the fund.

- The Minnesota State Colleges and Universities (MnSCU) System Office did not prepare complete and accurate financial statements for MnSCU activities within established time frames. Some of MnSCU's financial activities are not accounted for in the state treasury or recorded on MAPS, the state's accounting system. MnSCU and its institutions use a separate accounting system to record their financial activity. However, during fiscal year 1997, the MnSCU colleges and universities had not properly recorded $11.5 million of financial transactions on the system. In addition, the institutions did not submit certain key reconciliations and other supporting documentation for financial statement amounts. As a result, significant additional analysis and adjustments were necessary to prepare the financial statement information. Ultimately, MnSCU was not able to reconcile cash and investment variances of S655,000 between the financial statements and the accounting system.

- The Department of Finance did not properly coordinate state agency completion of supplemental federal expenditure schedules. In accordance with the Single Audit Act of 1984, as amended in 1996, the state must prepare a supplemental statement of expenditures by federal program. Because the state does not require a uniform method of identifying and accounting for federal programs in MAPS, the Department of Finance relies on individual state agencies for statement preparation. The department prepared a preliminary summary of expenditures by program from information recorded on MAPS and provided it to the state agencies to assist them in preparing the statements. However, the report contained inaccurate data, and agencies did not understand how to use it. As a result, the preliminary statements prepared by the agencies were inaccurate. To correct these statements, we made audit adjustments totaling $207 million for programs administered by the Department of Human Services and adjustments totaling $50 million for programs administered by CFL.

Recommendation

- *The Department of Finance should work with the various state agencies to ensure that staff members understand applicable accounting principles and how to obtain accurate information for financial statement preparation.*

3. The Department of Finance did not cancel outstanding warrants in accordance with statutory requirements.

The Department of Finance did not identify and cancel warrants that were outstanding in excess of six months. Minn. Stat. Section 16A.45, Subd. 1 provides, in part:

> Once each fiscal year, the commissioner and the treasurer shall cancel upon their books all outstanding unpaid commissioner's warrants, except warrants issued for federal assistance programs, that have been issued and delivered for more than six months prior to that date and credit to the General Fund the respective amounts of the canceled warrants.

As of June 30, 1997, warrants totaling $7.8 million had been outstanding for six months or more. Of that total, $5.1 million had been outstanding for one year or more. Some of the warrants had been outstanding since 1991. Although the warrants represent valid obligations of the state, and some may eventually be redeemed, canceling the older outstanding warrants would provide additional monies to the General Fund.

Recommendation

- *The Department of Finance should comply with statutory provisions and ensure that all warrants outstanding for more than six months are canceled. If the department thinks it is not cost beneficial to cancel warrants after only six months, it should seek a revision to the statutory provision.*

Chapter 3. Debt Administration

Chapter Conclusions

The Department of Finance designed internal controls over debt transactions to provide reasonable assurance that amounts were authorized and accurately reported in the annual financial statements. The department complied with statutory provisions tested for the sale of $170,000,000 in general obligation bonds. In addition, the department appropriately transferred $330,802,000 to the Debt Service Fund for future debt redemption in accordance with constitutional and statutory provisions. Also, 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 1997, the Department of Finance issued $170,000,000 in general obligation bonds for capital related projects.

The division also calculates legally required transfers to the Debt Service Fund to accumulate funds for repayment of the general obligation bonds. Various constitutional and statutory 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 1997.

Table 3-1
Operating Transfers to the Debt Service Fund
Fiscal Year 1997

Transferred From	Amount
Primary Government:	
General Fund	$295,481,000
Building Fund	12,766,000
Trunk Highway Fund	7,193,000
Maximum Effort School Loan Fund	2,353,000
Other Funds	2,538,000
Component Units	10,471,000
Total	$330,802,000

Source: State of Minnesota Fiscal Year 1997 Comprehensive Annual Financial Report.

Department of Finance

The cash and debt management division also administers the master lease program, which consolidates lease purchases. The program attempts 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 generally limited to equipment with a capital value of more than $100,000 and a useful life of more than 10 years. Master lease purchases in fiscal year 1997 totaled $13.9 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 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 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?

We gained an understanding of applicable policies and procedures relating to debt administration and tested compliance with statutory provisions relating to general obligation 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 $170,000,000 complied with statutory provisions tested. The department appropriately transferred $330,802,000 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.

Chapter 4. Administration of State and Federal Programs

Chapter Conclusions

The municipal energy loan balances and the 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. 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 programs that were material to the state's financial statements in fiscal year 1997, 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.

Municipal Energy Loan Program

In conjunction with the Department of Public Service, the Department of Finance administers the municipal energy loan program. These 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 revenue 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 4-1 shows the status of municipal energy loans in fiscal year 1997.

Table 4-1
Municipal Energy Loans Receivable
Fiscal Year 1997 Activity

	Federal Fund Amount	Building Fund Amount
Loan Balance, July 1, 1996	$4,293,247	$9,338,739
New Loans Issued	1,367,482	2,427,386
Loan Repayments	(1,353,242)	(1,590,846)
Loan Balance, June 30, 1997	$4,307,487	$10,175,279

Source: State of Minnesota Fiscal Year 1997 Comprehensive Annual Financial Report and Department of Finance supporting schedules.

Audit Objectives and Methodology

Our review of the municipal energy loan program included the following objective:

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

We interviewed department 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 supported by approved loan agreements.

Conclusions

The Building and Federal Fund's municipal energy loan balances were accurately reported in the state's annual financial statements. The department designed internal controls to provide reasonable assurance that municipal 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 1997.

Table 4-2
Transfers to the University of Minnesota
Fiscal Year 1997

Fund	Amount
General	$493,124,000
Building	48,536,742
Health Care Access	2,482,000
Total	$544,142,742

Source: State of Minnesota Fiscal Year 1997 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 designed internal controls to provide reasonable assurance that appropriation transfers were properly disbursed.

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 1997, the state's interest liability to the federal government totaled $30,539, while the federal liability to the state totaled $1,692,515.

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 submitted by the various state agencies.

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 1997 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 allocates 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 establishes the criteria for allowable costs 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 1997, agencies reimbursed $16.5 million to the General Fund for statewide indirect costs.

Audit Objectives and Methodology

Our review of indirect cost recoveries was 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 department 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 Services 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.

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Status of Prior Audit Issues
As of January 23, 1998

Most Recent Audit

March 19, 1997, Legislative Audit Report 97-14 focused on selected state and federal programs as part of the Statewide Financial and Federal Compliance Audit. The audit covered areas material to the state of Minnesota's financial statements including general obligation bond sales, debt service transfers, master lease transactions, municipal energy loans, and appropriation transfers to the University of Minnesota. The audit also covered federal requirements relating to cash management and indirect costs. The department implemented the recommendations discussed in the audit, except for Finding 1 which is repeated in this report.

Other Audit History

March 29,1996, Legislative Audit Report 96-13 objectives were similar to the Legislative Audit Report 97-14 described above. The audit covered fiscal year 1995 expenditures material to the state's financial statements and the Single Audit. The report included three findings which were all implemented by the next year.

State of Minnesota Audit Follow-Up Process

The Department of Finance, on behalf of the Governor, maintains a quarterly process for following up issues cited in financial audit reports issued by the Legislative Auditor. The process consists of an exchange of written correspondence that documents the status of audit findings. The follow-up process continues until Finance is satisfied that the issues have been resolved. It covers entities headed by gubernatorial appointees, including most state agencies, boards, commissions, and Minnesota state colleges and universities. It is not applied to audits of the University, and quasi-state organizations, such as the metropolitan agencies or the State Agricultural Society, the state constitutional officers, or the judicial branch.

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March 3, 1998

James R. Nobles
Legislative Auditor
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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.

We faced many challenges in preparing the Comprehensive Annual Financial Report the past two years. Improvements were made in our processes this past year as we gained a better understanding of MAPS, its subsystems and the relationship with other agencies' systems. We also realize that improvements still need to be made in providing accurate and timely information to state agencies and in educating state agencies in applicable GAAP reporting requirements.

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 agency staff to ensure that record dates are accurate;*
- *develop a process to identify accrued liabilities for interface transactions; and*
- *establish appropriate guidelines for testing payment transactions.*

Response

The department did provide state agencies with additional guidance on the correct use of the various date fields in MAPS. We also performed additional testing of interface transactions.

We will reevaluate the entire process used to identify and accumulate accrued liabilities. We will then redesign the process as necessary to correctly identify liabilities at year end. This process will include testing additional transactions, working with state agencies to properly record transactions, and adding the date of record field to the interface program.

Person responsible: Harley Will

Estimated completion date:
evaluation and redesign - June 30, 1998
testing - October 15, 1998

Recommendation

The Department of Finance should work with the various state agencies to ensure that staff members understand applicable accounting principles and how to obtain accurate information for financial statement preparation.

Response

In March, we will begin meeting with staff at the various state agencies that have been identified as needing assistance in preparing accurate financial statements within the established time frames. We will help them understand the underlying principles related to financial statement preparation. We will also discuss improvements that can be made in the process so that the statements are prepared timely. This will be an ongoing process through October when the financial statements are due.

The report prepared for agency use in single audit reporting captured data in the MAPS grants subsystem. Because using the subsystem is optional, the information in the report was not always complete. The report of federal expenditures will be redesigned using data from the Information Warehouse to supplement or replace the MAPS grants subsystem reports. We will also prepare better instructions on report usage.

Person responsible: Harley Will

Estimated completion date: June 30, 1998

Recommendation

The Department of Finance should comply with statutory provisions and ensure that all warrants outstanding for more than six months are canceled. If the department thinks it is not cost beneficial to cancel warrants after only six months, it should seek a revision to the statutory provision.

Response

We have begun the process of canceling all warrants outstanding for more than six months. We will also establish a process to cancel warrants every June. The department will review the clearing patterns for warrants and determine whether a revision of the statutory provision is necessary.

Person responsible: Paul Conery   Estimated completion date: March 31, 1998

Sincerely,

Wayne Simoneau

Wayne Simoneau
Commissioner