MnSCU System Office

Financial Audit
For the Period July 1, 1995 through June 30, 1998

August 1999

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Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

99-42

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SUMMARY

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MnSCU System Office

Financial Audit
For the Period July 1, 1995, through June 30, 1998

Public Release Date: August 5, 1999 No. 99-42

Background

The Minnesota State Colleges and Universities System (MnSCU) began operations on July 1, 1995. The Legislature merged state universities, community colleges, and technical colleges into one system. The MnSCU Board of Trustees established a system office to provide administrative and functional support to the 36 colleges and universities.

Our audit scope included a review of the system office financial management, payroll expenditures, consultant contract expenditures, other administrative expenditures, and the financial management of Minnesota State University-Akita for the period July 1, 1995, through June 30, 1998.

Conclusions

MnSCU's system office operated within its available resources and had an effective process to monitor revenue and expenditure budgets. The system office had adequate controls in place to provide reasonable assurance that financial activities were properly recorded on MnSCU accounting and MAPS. However, the system office did not have adequate controls over access to its computerized business systems.

We concluded that the system office had effective controls to ensure that its payroll, consultant contracts, and administrative expenditures were authorized and accurately recorded in the accounting systems. We found, however, that the system office did not independently verify that the payroll clerk properly input payroll hours. In addition, the system office did not comply with applicable contracting laws and internal procedures when awarding three Minnesota Satellite and Technology (MnSAT) contracts. The system office also did not have adequate controls over fixed assets.

While we concluded that MnSCU complied with the provisions of the contract for Minnesota State University-Akita, we noted that concerns relating to the educational and financial operation of that campus exist. MnSCU continues to provide large financial subsidies to operate this campus. American and Japanese student enrollment goals have not been met. The cost per student is significantly higher than other MnSCU universities, and MnSCU's proportionate share of funding has increased. A MnSCU work group is in the process of analyzing the educational and financial management issues associated with Minnesota State University-Akita. MnSCU has to determine whether the educational benefits justify the costs of operating this campus and if changes to the financial arrangements need to be made.

The system office agreed with the findings and recommendations contained in the audit report. The system office has developed a corrective action plan that includes assigning responsibility to system office personnel for ensuring that the recommendations will be implemented.

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

Representative Dan McElroy, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Morrie J. Anderson, Chancellor
Minnesota State Colleges and Universities

Members of the Minnesota State Colleges and Universities Board of Trustees

We have audited the Minnesota State Colleges and Universities (MnSCU) system office for the period July 1, 1995, through June 30, 1998, as further explained in Chapter 1. Our audit scope included financial management, payroll expenditures, consultant contract expenditures, other administrative expenditures, and the financial management of Minnesota State University-Akita, Japan.

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. These standards require that we obtain an understanding of management controls relevant to the audit. These standards also require that we design the audit to provide reasonable assurance that the system office complied with the provisions of laws, regulations, contracts, and grants significant to the audit. The management of the system office is responsible for establishing and maintaining the internal control structure and for compliance with applicable laws, regulations, contracts, and grants.

This report is intended for the information of the Legislative Audit Commission and the management of the MnSCU system office. This restriction is not intended to limit the distribution of this report, which was released as a public document on August 5, 1999.

James R. Nobles Legislative Auditor	Claudia J. Gudvangen, CPA Deputy Legislative Auditor

End of Fieldwork: June 25, 1999

Report Signed On: August 2, 1999

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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
Jim Riebe, CPA	Audit Manager
Jack Hirschfeld, CPA	Auditor-In-Charge
Scott Tjomsland, CPA	Auditor
Crystal Eskridge	Auditor
Charles Klein	Auditor

Exit Conference

We discussed the findings and recommendations with the following representatives of the MnSCU system office at the exit conference held on July 19, 1999.

Morrie Anderson	Chancellor
Laura King	Vice Chancellor/Chief Financial Officer
Bill Tschida	Vice Chancellor, Personnel
Anne Weyandt	Vice Chancellor, Labor Relations
Rosalie Greeman	Associate Vice Chancellor, Financial Reporting
Rick Ellefson	System Office Business Manager
Reede Webster	Director, Akita Support Office
John Asmussen	Executive Director of Internal Auditing
Jennifer Richter	West Metro Audit Coordinator

Chapter 1. Introduction

The Minnesota State Colleges and Universities System (MnSCU) began operations on July 1, 1995. At that time, the Legislature merged the state universities, community colleges, and technical colleges into one higher education system. Minn. Stat. Section 136F assigns the powers necessary to govern the state colleges and universities to the MnSCU Board of Trustees. The Board of Trustees employs system office staff to support MnSCU operations.

The system office comprises various divisions that provide administrative and program support to all 36 MnSCU colleges and universities. The system office organization chart is provided in Figure 1-1. All divisions report to the Chancellor's Office, except for Internal Auditing which reports to the Board of Trustees.

The system office operates a campus services unit that provides administrative services to all of the institutions. Campus services unit costs are charged back to the institutions. The approved campus services unit budget for fiscal year 1998 included the following services: Attorney General, computer systems, debt service principal and interest, library system service, loan collection services, and Legislative Auditor services. The system office allocated campus services costs totaling $24 million back to the colleges and universities in fiscal year 1998.

Our audit scope included financial management of the system office, including its relationship with the Northstar State University Foundation (Chapter 2), system office payroll expenditures (Chapter 3), consultant contract expenditures (Chapter 4), other administrative expenditures (Chapter 5), and a review of the Minnesota State University-Akita contract (Chapter 6). The Northstar State University Foundation secures gifts and grants for MnSCU universities and acts as a liaison with the universities and their foundations. A private CPA firm audits the foundation's financial statements. We reviewed the system office contract with the foundation and the administrative support the system office provides to the foundation.

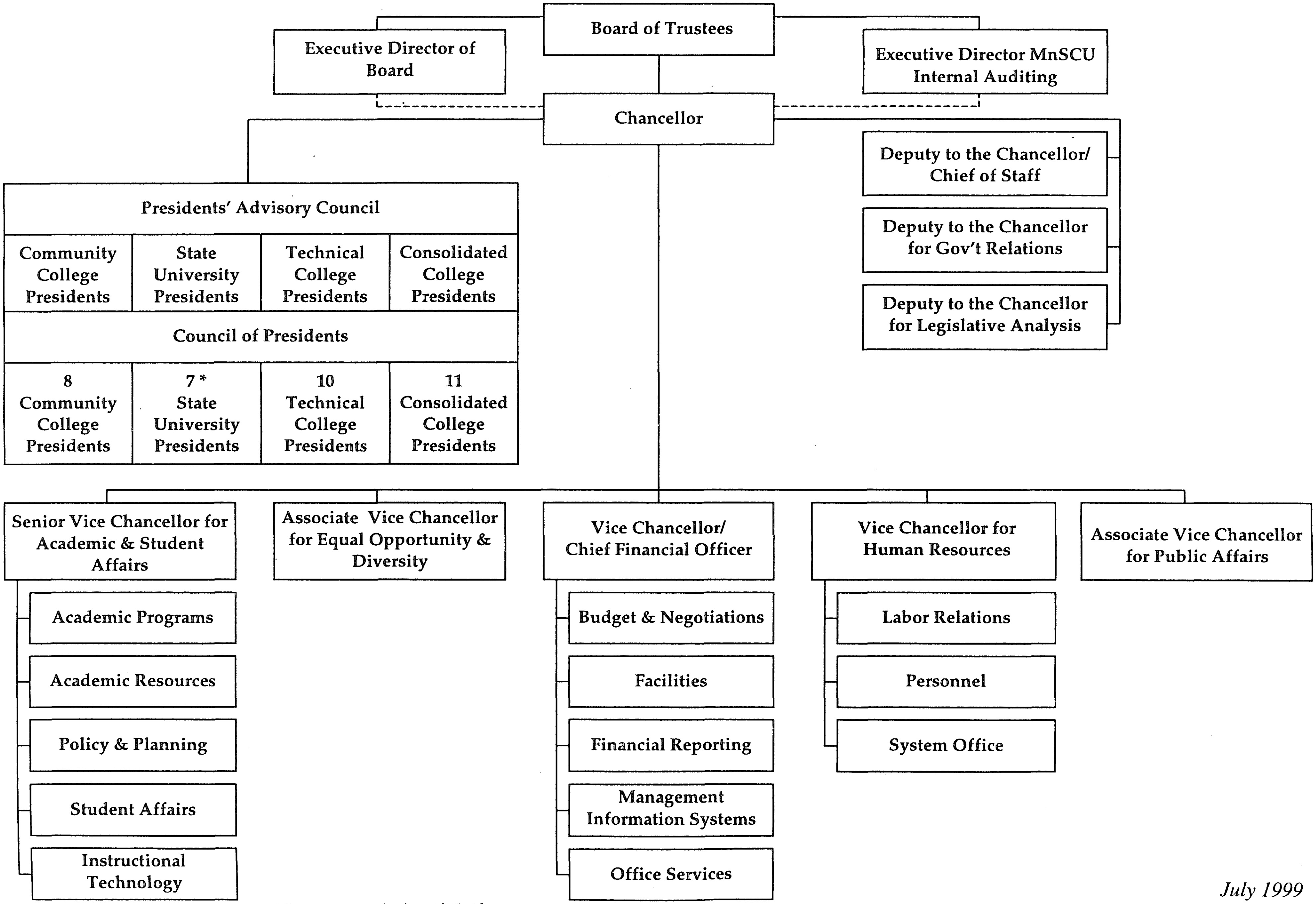
The material financial activity for the system office in fiscal year 1998 is shown in Table 1-1. Revenues consist mainly of state appropriations, federal funds, and gifts. Expenditures consist primarily of payroll, supplies, purchased services, and other administrative costs.

The system office has financial management responsibilities for certain operations outside of the scope of this audit. We provide audit coverage of the MnSCU supplemental retirement program, major capital project expenditures, and federal vocational education grants during our annual Statewide Financial Audit. A private CPA firm audits the Revenue Bond Fund. This fund accounts for the financial activity related to the construction and maintenance of residential and student facilities on state university campuses.

MnSCU
Minnesota State Colleges & Universities

SYSTEM OFFICE

Figure 1-1



* Does not include MSU Akita

July 1999

Table 1-1
MnSCU System Office
Fiscal Year 1998 Financial Activity

	General Fund	Special Revenue Funds	Gift Fund
Beginning Balance	$9,551,947	$163,280	$547,510
Sources:			
State Appropriation	$22,025,130		
Federal Grants		$7,804,795	
Private Grants			$1,601,047
Investment Income	3,522,518		
Non-Mandatory Transfers In	1,015,057		
Other Income	701,534		
Total Sources	$27,264,239	$7,804,795	$1,601,047
Uses:			
Payroll	$10,030,295	$607,174	$163,324
Consultant Services	6,308,034	$795,473	98,586
Computer Production	461,361		
Debt Principal and Interest	6,880,133		
Supplies	6,091,008	149,880	14,492
Purchased Services	9,262,711	385,396	43,628
Equipment	2,867,362	6,358	
Aid to Higher Education		5,346,028	
Financial Aid			640,390
Non-mandatory Transfers		118,047	
Other Expenditures	695,585	544,894	4,320
Charge-backs (2)	(24,442,363)		
Total Uses	$18,154,126	$7,953,250	$ 964,740
Fund Balance as of June 30, 1998	$18,662,060	$ 14,825	$1,183,817

Note 1: The financial information is presented in the budgetary basis of accounting. The basis does not include long-term assets and liabilities. Examples of financial activities not included in the table are compensated balances, estimated to be $1,780,154. The system office has restricted $9.593 million of the ending General Fund balance for future commitments that include prior year salary obligations, prior year encumbrances, dedicated funding, and other administrative obligations. The ending General Fund balance also includes $8.961million of system-wide reserves.

Note 2: The system office incurs costs applicable to the individual colleges. The negative balance in this account represents the allocation of these costs to the colleges.

Source: MnSCU to MAPS Trial Balance as of March 17, 1999.

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Chapter 2. Financial Management

Chapter Conclusions

MnSCU system office operated within its available resources and had an effective process to monitor revenue and expenditure budgets. The system office had adequate controls in place to provide reasonable assurance that financial activities were properly recorded on MnSCU accounting and MAPS. However, the system office did not have adequate controls over access to its computerized business systems.

We concluded that the system office properly identified expenditures charged back to individual colleges and universities and accurately recorded the charge-backs on the accounting system. The system office did not, however, reconcile the foundation's receipts and expenditures to bank records.

MnSCU system office receives most of its funding from General Fund appropriations, federal and private grants, and investment income. The individual cost centers develop their budgets based upon prior year revenues and expenditures, considering any anticipated changes. The system office management team reviews the individual budgets and makes necessary adjustments. The Chancellor reviews and approves the system office budget and submits it to the Board of Trustees for final approval.

The system office also has a process for monitoring the status of the budget and the corresponding revenues and expenditures throughout the year. The system office produces monthly reports for review by the cost center supervisors. Budgetary staff also meet periodically with the cost center supervisors to review their financial activity. The monitoring process includes controls over the transfer of funding between cost centers and divisions, and for procedures for increases to individual cost center budgets.

The statewide accounting system (MAPS) is the primary accounting system for funds held in the state treasury. The system office uses the MnSCU accounting system to initiate transactions that interface into MAPS to generate warrants from the state treasury. A delegation of authority and an approval system is used to control financial transactions.

The system office retains a portion of the MnSCU appropriation to pay for certain system-wide activities performed for colleges and universities. These system-wide activities include computer systems, debt service principal and interest payments, and other administrative activities. At the end of the fiscal year, the system office determines the amount of expenditures for each of the activities and allocates the costs to the colleges. There is a specific allocation formula used for each of the activity types. The expenditures are backed out of the system office cost centers and charged to the colleges. Appropriation amounts equal to the costs are also transferred to the colleges.

MnSCU System Office

The system office had various inconsistencies when recording financial activity during the initial years of the merger. We noticed unusual amounts recorded in some accounts, and some inconsistency in the recording of some financial activity in the early years of operation. However, we saw that improvements were made, and that the recording of financial activity was appropriate and consistent in fiscal years 1998 and 1999.

Audit Objectives and Methodology

Our review of the MnSCU system office financial management focused on the following objectives:

- Did the system office internal controls provide reasonable assurance that financial activities were properly recorded on the MnSCU and MAPS accounting system?

- Did the system office internal controls provide reasonable assurance that it operated within available financial resources and in compliance with applicable legal provisions and management's authorization?

- Did the system office properly determine expenditures to charge back to the individual colleges and accurately record the charge-backs in the accounting system?

To answer these questions, we interviewed system office personnel to gain an understanding of the use of MnSCU accounting for program areas included within our audit scope. We also gained an understanding of management controls, such as budget development and monitoring, in place over financial activities.

Conclusions

MnSCU system office operated within its available resources and had an effective process to monitor revenue and expenditure budgets. The system office had adequate controls in place to provide reasonable assurance that financial activities were properly recorded on MnSCU accounting and MAPS. However, as discussed in Finding 1, the system office did not have adequate controls over access to its computerized business systems.

The system office properly identified expenditures to charge back to individual colleges and universities and accurately recorded the charge-backs on the accounting system. The system office did not, however, reconcile the foundation receipts and expenditures to bank records as reported in Finding 2.

MnSCU System Office

1. Security controls over system office employees' access to computerized business systems need improvement.

MnSCU system office did not adequately monitor its employees' access to its computerized business systems, including MnSCU accounting, SCUPPS personnel/payroll, and SEMA4. Within the personnel and payroll systems we found the following improper access:

- two employees had incompatible access to both SCUPPS and SEMA4;
- four employees had unnecessary access to payroll and human resource functions within SEMA4; and
- at least one ex-employee had access to the system even though the employee no longer worked at the system office.

Employees with unauthorized access on SCUPPS and SEMA4 could improperly add employees to the payroll or could pay employees unauthorized amounts. Our testing, however, did not identify any improper payroll or personnel transactions.

We also noted the following computer access control weaknesses in the MnSCU accounting system:

- ten system office employees had incompatible access for both purchasing and disbursing functions.
- one employee had access to purchasing functions, but did not have purchasing responsibilities.

Individuals with access to purchasing functions should not have access to disbursing functions. The incompatible functions could result in individuals purchasing items for personal use or making other inappropriate payments.

The system office has primary authority and responsibility to ensure employee access is necessary based upon job responsibilities. However, the system office did not periodically review system user reports to monitor employee access to the accounting systems.

Recommendation

- *The MnSCU system office should monitor security profiles to insure employee access is restricted to job responsibilities.*

2. The system office did not reconcile foundation accounting records to bank statements.

The system office did not reconcile the foundation accounting records to bank statements. The system office provided administrative support to the Northstar State University Foundation. The system office collected donations for the foundation, deposited receipts in the bank, and recorded the donations on the monthly cash receipts log. The foundation in turn provided MnSCU with funding for special projects and scholarships. A private CPA firm audited the financial statements of the foundation for the year ended June 30, 1998. In a management letter dated December 1998, the CPA firm recommended that the system office staff perform a monthly reconciliation of the foundation bank account. As of May 1999, staff had not begun reconciling the bank account to the accounting records. To ensure the accuracy of accounting and bank records, the system office should perform timely and complete reconciliations of accounting records to bank statements.

The system office also did not reconcile the foundation cash receipts log to the monthly summary of financial activity report. System office staff provided the foundation board with a monthly summary report showing the beginning fund balance, receipts, expenses, and the final fund balance. Fiscal year 1999 receipts as of May 24, 1999, amounted to $263,599. In comparing receipts recorded on the cash receipts log to the summary report, we noted a difference of $229. The system office staff was unaware that the cash receipts log differed from the summary report. After advising them of the difference, they reconciled their records and identified board meal reimbursement as the reason for the difference. The system office should reconcile their cash receipts log to the monthly summary report to insure that the foundation accounting records are accurate.

Recommendation

- *The system office should reconcile the foundation's receipt log to the monthly accounting records and to the bank statements in a timely manner.*

Chapter 3. Payroll

Chapter Conclusions

The system office's internal controls provided reasonable assurance that employees received the correct compensation and that payroll expenditures were accurately reported in the accounting records. However, the system office did not independently verify that the payroll clerk properly input payroll hours into SEMA4. Also, the system office did not adequately monitor access controls over SCUPPS and SEMA4 (see Chapter 2 for a discussion of access control weaknesses). For the items tested, the system office compensated its employees in compliance with applicable bargaining unit contract provisions and management's authorization.

We also concluded that the system office paid expense reimbursements and per diem amounts to members of the MnSCU Board of Trustees in compliance with applicable laws and regulations for the amounts tested.

The MnSCU system office employed about 153 staff during fiscal year 1998. Payroll expenditures totaled approximately $10.3 million for the fiscal year ending June 30, 1998.

During fiscal year 1996, the system office used the State Colleges and Universities Personnel/Payroll System (SCUPPS) to process salary and personnel transactions. At that time, the state's personnel/payroll system (PPS) was used to process deductions and generate payroll warrants. Early in fiscal year 1997, the system office began using the State Employee Management (SEMA4) system for payroll processing.

The MnSCU system office had separate human resource and payroll sections. The human resource section updated SCUPPS for personnel appointments and salaries. The payroll section input payroll into SEMA4 during mass time entry and was responsible for ensuring proper recording of payroll expenditures in MnSCU accounting.

Audit Objectives and Methodology

The primary objectives of our audit were to answer the following questions:

- Did the system office's internal controls provide reasonable assurance that payroll expenditures were accurately reported in the accounting records and that employees received the correct compensation?

- Did the system office comply with the significant finance related legal provisions and management's authorization concerning payroll and board member per diem and expense reimbursements?

To meet these objectives, we interviewed system office employees to gain an understanding of the internal control structure over the payroll and personnel process. We analyzed payroll expenditures to determine proper recording of payroll transactions, reviewed source documents to determine proper authorization, and tested a sample of payroll expenditures to ensure proper payment pursuant to contract provisions.

Conclusions

The system office's internal controls provided reasonable assurance that employees received the correct compensation and that payroll expenditures were accurately reported in the accounting records. However, as discussed in Finding 4, the system office did not independently verify that the payroll clerk properly input payroll hours into SEMA4.Also, the system office did not adequately monitor access controls over SCUPPS and SEMA4, as discussed in Chapter 2, Finding 1. For the items tested, the system office compensated its employees in compliance with applicable bargaining unit contract provisions and management's authorization. The system office also paid expense reimbursements and per diem amounts to members of the MnSCU Board of Trustees in compliance with applicable laws and regulations.

3. The system office did not independently verify that the payroll clerk properly input payroll hours.

The system office did not assign an independent staff member responsibility to verify hours processed on SEMA4. A payroll clerk entered hours into SEMA4 during mass time entry. This same individual also verified that all employee hours were properly posted into SEMA4. In essence, the payroll clerk verified the clerk's own input. Ideally, independent staff should verify payroll hours input and processed in SEMA4. Payroll is one of the system office's most significant cost categories. Without using independent staff to verify payroll transactions, the system office increases the risk that inaccurate posting of hours worked or leave taken could occur and go undetected.

Recommendation

- *The MnSCU system office should provide for an independent verification of the accuracy of timesheet hours processed in SEMA4.*

Chapter 4. Consultant Contracts

Chapter Conclusions

MnSCU system office's internal controls provided reasonable assurance that consultant contract expenditures were accurately reported in the accounting records and that expenditures were made in accordance with management's authorization. With the following exception, the system office complied with significant finance-related legal provisions regarding the consultant contracts we tested. MnSCU system office did not comply with applicable contracting laws and procedures when awarding three Minnesota Satellite and Technology (MnSAT) contracts.

MnSCU defines consultant contracts as agreements entered into for consultant, professional, or technical services usually on a short-term basis for a specific purpose. The system office issued $7.8 million in consultant contracts for fiscal year 1998. These contracts were for architectural services, legal services, computer services, and other professional services.

The system office is required to issue contracts in accordance with Minn. Stat. Section 471.345, Uniform Municipal Contracting Law, and Minn. Stat. Section 136F.581, Purchases and Contracts. MnSCU is exempt from the Department of Administration contracting laws included in Minn. Stat. Section 16C. MnSCU policy and procedure 5.5.1, however, provides the guidelines used in approving and processing contracts. Contracts over $50,000 must be reviewed and approved by the vice chancellor/chief financial officer. This responsibility may be delegated to appropriate personnel.

Audit Objectives and Methodology

The primary objectives of our review of consulting contract expenditures were to answer the following questions:

- Did the system office's internal controls provide reasonable assurance that consultant contracts were accurately reported in the accounting records and that expenditures were made in accordance with management's authorization?

- Did the system office comply with significant finance-related legal provisions governing consulting contracts?

In response to a complaint filed with our office, we also reviewed the contract selection process used by the system office to purchase digital equipment and services for its Minnesota Satellite and Technology (MnSAT) division. Our objective was to determine if MnSCU followed applicable laws and internal policies in awarding the contract and not to determine if the contract was awarded to the appropriate vendor.

To address these objectives, we interviewed system office staff to obtain a general understanding of the internal control structure over the consulting, professional, and technical contract process. We analyzed contract expenditures and tested 21 contracts for management's authorization and compliance with MnSCU's Professional/Technical contract guidelines and procedures.

Conclusions

The MnSCU system office's internal controls provided reasonable assurance that consultant contracts were accurately reported in the accounting records and in compliance with management's authorization. With the exception of three MnSAT contracts, the MnSCU system office complied with applicable laws and procedures for the items we tested. In Finding 4, we discuss the problems associated with the MnSAT contracting process.

4. The system office did not comply with applicable contracting laws and procedures when awarding three MnSAT contracts resulting from one Request for Proposal.

The system office did not comply with Uniform Municipal Contracting Laws and MnSCU policies and procedures when awarding a MnSAT contract for digital equipment and services. MnSAT delivers information and training to government, education, business, and industry via satellite, microwave broadcast, and other transport mediums. We reviewed a September 1997 MnSAT Request for Proposal (RFP) for antenna equipment, switching and transmission services, and a help desk. The RFP resulted in the system office initiating three contracts with the successful vendor totaling $1,548,150. According to system office staff, the RFP was later split into three contracts to facilitate administrative accounting for the project.

We found numerous problems concerning the MnSAT vendor selection process. First, the system office did not comply with Uniform Municipal Contracting Laws when it used a RFP to procure equipment. Secondly, the system office did not properly prepare and advertise the RFP. Finally, the system office did not follow MnSCU procedures when planning for the contract, receiving proposals, and documenting contract changes.

- The system office did not solicit sealed bids for the purchase of equipment. The system office incorporated the purchase of equipment in a RFP. The RFP required that the successful vendor provide about $245,000 in equipment, in addition to providing professional/technical services such as transmission and help desk services. MnSCU policies and procedures and the Uniform Municipal Contracting Laws require sealed bids for equipment purchases that exceed $25,000. MnSCU can include equipment in an RFP provided that a sealed bid procurement for the equipment is completed either by MnSCU or the successful vendor.

- The system office did not properly prepare the RFP. We have the following concerns about the system office's procedures for developing and advertising the RFP:

  -- The system office prepared the RFP after consultation with employees of a prospective responder when drafting the RFP's equipment specifications. MnSCU's Professional/Technical Contract Guidelines Handbook states: "No one should discuss the potential contents of an RFP or potential RFP requirements with anyone prior to the actual publication date of the RFP as this provides an unfair advantage to those responders." The system office may have given the prospective responder an unfair advantage by allowing them to participate in defining the equipment specifications.

-- The system office did not outline the evaluation criteria in its RFP and did not develop a scoring method to evaluate proposals. MnSCU's Professional/Technical Contract Guidelines Handbook states that evaluation criteria and their weights should be identified in detail in the RFP. Without detailed evaluation criteria and a scoring method, the risk of vendor objections or appeals increases. The evaluation team members did, however, evaluate the submitted proposals against established criteria.

-- The system office did not advertise the RFP in an official newspaper as required by MnSCU policies and procedures 5.5.1. The RFP was inappropriately advertised in the State Register's subscription supplement, rather than the State Register standard publication. Consequently, the public notice of the RFP was limited. Appropriate advertising is necessary to obtain the benefits of competition, and to give all qualified parties an opportunity to compete for government contracts.

-- The system office accepted a RFP from an unsuccessful vendor that was submitted after the established deadline. MnSCU's Professional/Technical Contract Guidelines Handbook states that "late proposals will not be accepted."

- The system office did not properly document important contracting information. We had three issues associated with this concern.

-- The system office did not document the submission of proposals and could not verify when it received the winning vendor's proposal. The system office did not prepare evaluation scores to document selection of the winning vendor. In addition, the system office did not record who was present at negotiations or the results of negotiation meetings.

-- The system office did not properly document contract changes. The system office did not amend contracts for added equipment purchases and extra services amounting to approximately $112,000. MnSCU policies require that a change in any provision of the contract must be approved in the same manner as the original contract. Formal contract amendments are necessary to enforce the contract and to ensure that both parties understand contract terms.

MnSCU System Procedure 5.5.1, Part 2, requires that institutions submit a contract plan memorandum to the vice chancellor of finance for approval. The plan should explain the need for the contract, the contractor selection process, the contract cost, and available funding. We think the system office should follow this procedure for future system office contracts to help ensure compliance with contracting requirements.

MnSCU System Office

Recommendations

- *The system office should solicit sealed bids for equipment purchases that exceed $25,000, as specifically required by the Uniform Municipal Contracting Laws.*

- *In planning for system office contractual service contracts, the system office should adopt MnSCU System Procedure 5.5.1, Part 2, which requires that a contract plan memorandum be submitted to the vice chancellor of finance for approval. The plan should explain the need for the contract, the contractor selection process, the contract cost, and available funding.*

- *The system office should consistently follow MnSCU System Procedures in developing request for proposals, advertising contract solicitations, identifying evaluation criteria, documenting pertinent contract data, and amending contracts when terms or conditions change.*

Chapter 5. Other Administrative Expenditures

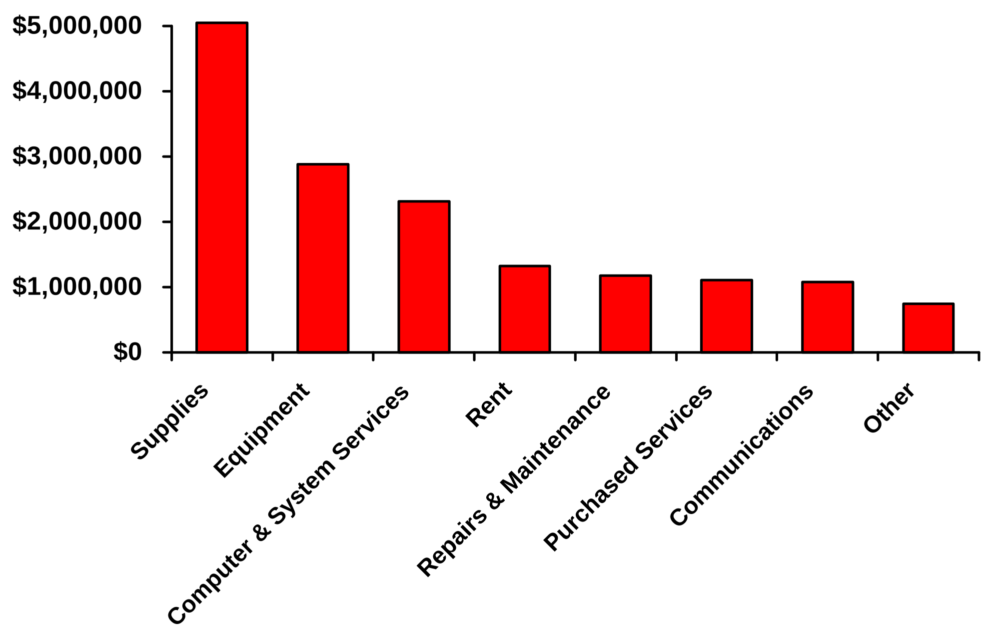
Chapter Conclusions

The MnSCU system office's internal controls provided reasonable assurance that other administrative expenditures were accurately reported in the accounting records and processed in accordance with management's authorization. However, the system office did not adequately control fixed assets.

For the items tested, the system office complied with significant finance-related legal provisions.

During fiscal year 1998, the system office spent over $15 million on administrative expenditures other than payroll and contractual services. Those expenditures included payments for supplies, equipment, computer and system services, rent, repairs and maintenance, purchased services, communications, and other miscellaneous categories including travel and employee development. Figure 5-1 shows expenditures by category for fiscal year 1998.

Figure 5-1
Other Administrative Expenditures
Fiscal Year 1998



Note: The chart reflects amounts before certain expenditures were charged back to individual colleges.
Source: MnSCU accounting system.

MnSCU System Office

Audit Objectives and Methodology

The primary objectives of our review of other administrative expenditures were as follows:

- Did the system office's internal controls provide reasonable assurance that other administrative expenditures were accurately reported in the accounting records and processed in accordance with management's authorization?
- Did the system office comply with the significant finance-related legal provisions governing administrative expenditures?

To meet these objectives, we interviewed system office personnel to gain an understanding of the procurement and disbursement processes. We reviewed a sample of expenditures to determine if the system office properly authorized, processed, and recorded the expenditures. We also reviewed the sample items to determine if the college complied with applicable legal provisions.

Conclusions

The system office's internal controls provided reasonable assurance that other administrative expenditures were accurately reported in the accounting records and processed in accordance with management's authorization. For the items tested, the system office complied with the significant finance-related legal provisions. However, as discussed in Finding 5, the system office did not perform timely physical inventories of fixed assets, and did not adequately separate duties for fixed assets in the management information systems unit.

5. The system office did not have adequate controls over fixed assets.

The system office did not complete a physical inventory until November 1998. At that time, the system office could not compare assets on hand to a master listing of fixed assets because it had not updated its fixed asset inventory records. Instead, it identified all fixed assets on hand and updated the fixed asset records. By not comparing fixed assets on hand to inventory records, the system office could not determine if all previously purchased assets were properly accounted for. Physical inventory counts and complete fixed asset records are necessary to safeguard and control assets.

In addition, one employee in the management information system (MIS) unit had incompatible duties that could result in errors or irregularities. That employee had responsibility for purchasing computers and computer-related equipment, authorizing the expenditures for those purchases, receiving purchased items, assigning fixed asset numbers, and recording fixed asset information in the inventory records. This individual authorized many of the equipment purchases from certain cost centers totaling about $920,000 for the three years ending June 30, 1998. Employees with the authority to purchase and receive items should not have access to primary inventory records. An employee with this authority could purchase items for personal use and avoid detection by not recording the items in the inventory records.

The MIS unit maintained the primary inventory records for computers and computer-related equipment on an Access database. The MnSCU accounting system has a fixed asset inventory system component that could be used as the primary fixed asset inventory record. By appropriately using the fixed asset component, the system office could improve separation of duties by restricting the MIS unit from having access to the fixed asset records. However, as of June 1999, the system office had not used the system.

Recommendations

- *The system office should develop policies and procedures to periodically inventory fixed assets.*

- *The system office should establish procedures that segregate the incompatible duties in the MIS unit.*

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Chapter 6. Minnesota State University – Akita Campus

Chapter Conclusions

MnSCU complied with the requirements of its contractual agreement with Japan to operate Minnesota State University – Akita (MSU-Akita). In 1989, the Minnesota State University System established an agreement with Yuwa Town, Japan, to operate the MSU-Akita campus. We found that MnSCU complied with the financial arrangements, including the payment of its designated share of the costs. MnSCU also complied with the administrative and academic requirements of the agreement.

However, because of financial and educational concerns, MnSCU established an internal work group to analyze issues associated with MSU-Akita. The work group issued a progress report in April 1999 and is scheduled to make a final presentation to the Board of Trustees in September. Ultimately, MnSCU will have to decide whether the educational benefits associated with MSU-Akita justify the costs of operating the campus. MSU-Akita has not met the anticipated attendance goals for either American or Japanese students. MnSCU continues to provide large financial subsidies to operate MSU-Akita. The cost per student is significantly higher than other universities, and MnSCU's proportionate share of funding has increased significantly.

Trade agreement discussions in1986 between President Reagan and Prime Minister Nakasone of Japan resulted in commitments for the MSU–Akita. Both governments intended to promote greater intercultural understanding and to expand trade between the two nations. This concept focused on using education as a means of developing productive relationships between the two societies. One component of the agreement was the establishment of American university campuses in Japan. It was envisioned that the schools would provide education and training to both Japanese and American students, focusing particularly on language and culture. The American universities would fund a portion of the academic programs and provide faculty and staff. The Japanese hosts would provide the financing for the university, and construct a campus appropriate to the American style of higher education.

The State University Board (SUB), now a part of MnSCU, submitted a competitive application to locate a campus in northern Japan. SUB was awarded the contract in February 1989. They were selected for a branch campus in Yuwa Town, Akita Prefecture, which is about 400 miles north of Tokyo. The campus serves Japanese and American students. American students enroll in a study-abroad program through MSU–Akita. The American students attend classes in Japanese language and culture. The Japanese students enroll in English as a Second Language courses and may enroll in general education classes. The ultimate goal is to transfer Japanese students to a MnSCU campus in America so the student may obtain a four-year degree.

MnSCU System Office

An agreement covering 25 years was negotiated between Yuwa Town, Japan, and the Minnesota State University Board in May 1989. The agreement provided that MnSCU develop and be responsible for the content and presentation of the curriculum. Yuwa Town was to be responsible for the construction and maintenance of the buildings, fixtures, furniture, and a majority of the operating costs. Parties to the contract completed an amendment in May 1993 to further clarify their financial responsibilities. This amendment provided that MnSCU pays all costs for American student recruitment, the cost of instructional personnel for the Japan Area Studies Department, and 80 percent of the American student room and board subsidy. MnSCU is also responsible for a prorated portion of administrative and plant-related costs. The Japanese sponsor pays for other personnel costs, the English as a Second Language instructional program costs, general educational costs, the majority of the physical plant and management costs, and costs for Japanese student recruitment. The agreement provides that the Japanese will reimburse MnSCU for their share of the costs. MnSCU has collected the financial reimbursement as required by the agreement.

American students enroll through St. Cloud State University, where tuition and fees are deposited. MnSCU pays for the operation of the MSU-Akita. Japan reimburses MnSCU on a scheduled basis. MnSCU payments and Japanese reimbursements are recorded in the General Fund.

The MnSCU Board of Trustees established an internal work group in December 1998 to address financial and educational concerns associated with MSU-Akita. The work group issued a progress report in April 1999 and is scheduled to make a final presentation to the Board of Trustees in September. The progress report recognized the difficulties of operating an international campus and identified several challenges for MSU-Akita including low student enrollment, budgetary concerns, and academic issues including accreditation and lack of college and university academic support.

MSU-Akita has not met the anticipated attendance goals for either American or Japanese students. The 1989 agreement anticipated that 750 Japanese students and 120 American students would enroll at MSU-Akita by the fourth year of operation. Since the inception of the agreement, American student enrollment has only reached about 42 percent of the goal, and Japanese enrollment has been about 77 percent of the goal. Because the initial attendance goals were not met, both parties reduced the projected attendance goals in 1997 and again in 1998.

The cost for American students at MSU-Akita is significantly higher than other MnSCU colleges. The most current figures available show that in fiscal year 1997 the state appropriation per FYE for MSU-Akita amounted to $18,879. The average appropriation per FYE for MnSCU universities was $3,980. These figures show that MSU-Akita is consuming a disproportionate share of the state appropriation. MnSCU's proportionate share of operating costs had declined from 1992 until 1999 when it increased substantially. Between fiscal year 1998 and 1999, the cost increased 42 percent from $1,004,016 to $1,427,785. MnSCU provided 16 percent of the cost for operating the campus in 1992. It now provides 25 percent of the funding.

Audit Objective and Methodology

The primary objective of our review of the MSU-Akita program was to answer the following question:

MnSCU System Office

- Did MnSCU administer the financial arrangements with Japan in accordance with the contract?

To address this objective, we interviewed system office staff to obtain a general understanding of the Akita program and its internal control structure. We analyzed revenues and expenditures, and examined the contract between MnSCU and Yuwa Town, Japan. We reviewed MnSCU's compliance with agreement provisions. This agreement included several provisions related to the operation of MSU-Akita, including education programs, facilities and staff, financial responsibilities, and other administrative issues. We tested compliance with the following provisions:

-- MnSCU was to provide three-year budgets annually in consultation with Yuwa Town;

-- MnSCU was to project American student enrollment to identify educational and financial obligations;

-- MnSCU was to develop and implement the curriculum and provide all academic programs and administrative services for the management of education programs;

-- MnSCU was to provide faculty and professional administrative personnel in consultation with Yuwa Town; and

-- MnSCU was to negotiate with Yuwa Town regarding the financial obligations of both participants.

We also reviewed Japan's reimbursement process. Finally, we reviewed the MnSCU internal work group report issued to the Board of Trustees in April 1999.

Conclusions

We found that MnSCU administered the financial arrangements with Japan in accordance with the contract terms. MnSCU provided its required share of financial support, and also complied with administrative and educational provisions of the contract.

We also found that MnSCU is addressing significant operational issues about MSU-Akita. Ultimately, MnSCU will have to decide whether the educational benefits associated with MSU-Akita justify the costs of operating the university. In light of the current low level of enrollment and the continued increase in costs, MnSCU is analyzing the educational benefits of operating MSU-Akita versus costs to determine whether it is economically feasible to maintain this campus. Factors under consideration include the lack of enrollment, the high cost per student, and MnSCU's increased share of funding. The analysis will include determination of Japan's ability to provide its share of the funding. The payment of the large operating subsidies impacts the funding of other MnSCU programs. A foreign campus and an international education provide an opportunity to students and an international focus to MnSCU. However, if the campus continues to require a large funding commitment, MnSCU may need to consider other alternatives.

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Status of Prior Audit Issues

Most Recent Audits

The MnSCU system office is comprised of the former Community College board office, the State University board office, and the Technical College board office. The most recent audits for these boards were as follows:

Community College Board Office-Legislative Audit Report 94-12, issued in September 1994, was a financial-related audit covering selected programs including payroll, appropriations, and repairs and replacements for the year ended June 30,1993.

State University System Board Office-Legislative Audit Report 95-47, issued in October 1995, was a financial-related audit covering selected programs including cash management and investments on a system-wide basis for the period July 1, 1993, through March 31, 1995.

Board of Technical Colleges-Legislative Audit Report 96-10, issued in March 1996, was a financial-related audit covering federal programs, construction aids, and post secondary vocational education for the year ended June 30, 1995.

We did not follow up on the status of these audit reports due to the significant reorganization of the boards into the MnSCU system office, and because the issues contained in the reports were not related to our current audit objectives.

State of Minnesota Audit Follow-Up Process

The Department of Finance, on behalf of the Governor, maintains a quarterly process for following up on issues cited in financial audit reports issued by the Legislative Auditor. However, Finance has delegated this responsibility for audits of the Minnesota State Colleges and Universities (MnSCU) to the MnSCU Office of Internal Auditing. MnSCU's Office of Internal Auditing process consists of quarterly activity reports documenting the status of audit findings. The follow-up process continues until the Office of Internal Auditing is satisfied that the issues have been resolved. The process covers all colleges and universities within the MnSCU system.

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MnSCU

Minnesota State Colleges & Universities

July 29, 1999

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

Dear Mr. Nobles,

The purpose of this letter is to respond to the recently completed audit of the MnSCU System Office for the period July 1, 1995 through June 30, 1998. The audit was completed as a part of the MnSCU-Office of the Legislative Auditor (OLA) FY1998-1999 contract for audit services including system wide and college and university audits. We have recently signed a new agreement with the OLA covering services in FY2000-2001. On behalf of the Board of Trustees and presidents and staff, we look forward to continued productive relations.

Please extend our appreciation to Mr. Jim Riebe, audit manager and Mr. Jack Hirschfeld, auditor-in-charge for their efforts on the System Office audit. The MnSCU System Office functions both as an activity center and on behalf of the thirty-six MnSCU colleges and universities. Consequently the financial administration is very complex and we appreciate their efforts.

This audit represents the first review of the administrative control structure created after the merger of the three former system offices. In many respects we faced the same challenges as the colleges and universities in establishing new internal control assurances to replace the methods of the state universities, community colleges and technical colleges system offices. Our staff had the added responsibility for assistance to campuses during the early, difficult years of the merger.

We are very pleased that your review found sufficient controls in place concerning budget administration, financial reporting, payroll and general administration. The audit concludes that the Board and the public can be assured that System Office financial activities are properly recorded and that budgets are established and appropriately

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controlled. The audit also found that the system wide charge back methods used are appropriate and well administered.

The audit also spent considerable time examining MnSCU's relationship with our Japanese partners at the MSU-Akita campus. We expect to conclude current discussions concerning this partnership with a report to the Board of Trustees in September and would be happy to forward a copy to your office at that time as well.

Attached please find specific responses to the audit findings.

Morris J. Anderson
Chancellor

Laura M. King
Vice Chancellor -
Chief Financial Officer

Enc.

MnSCU System Office Audit
July 1, 1995 – June 30, 1998
Response to findings

July 29, 1999

1. **Recommendation**: The MnSCU system office should monitor security profiles to insure employees access is restricted to job duties.

   Response: We agree with the finding. We are in the process of examining the access of all System Office staff and will make appropriate system access changes. We will institute a procedure to review system access on a periodic basis. Responsible individual – Rosalie Greeman, Associate Vice Chancellor for Financial Reporting.

2. **Recommendation**: The system office should reconcile the foundation's receipt log to the monthly accounting records and to the bank statements in a timely manner.

   Response: We concur and will implement a process for monthly bank reconciliations for the foundation accounts. Responsible individual – Linda Kohl, Associate Vice Chancellor for Public Affairs.

3. **Recommendation:** The MnSCU system office should provide for an independent verification of the accuracy of timesheet hours processed in SEMA4.

   Response: We agree with the finding and will institute steps to provide for independent verification of accuracy of payroll transactions. Responsible individual – Rick Ellefson, system office business manager.

4. **Recommendation**: The System Office should solicit sealed bids for equipment purchases over $25,000. In planning for system office contractual services contracts, the system office should adopt MnSCU system procedure 5.5.1, part 2, which requires that a contract plan memorandum be submitted to the vice chancellor of finance for approval. Lastly, the system office should consistently follow MnSCU system contracting procedures.

   Response: We agree that there were difficulties and errors associated with the process followed for the MnSAT contract for digital equipment and services. This was a complex project made more complex by the fiscal agent relationship with St Paul Technical College.

   At the time MnSAT was created (1989) , the expectation was that it would become self-supporting. Thus fiscal responsibilities remained at St Paul Technical College when the merger took place. Circumstances have changed and MnSAT is now aligned with the Instructional Technology unit of the MnSCU Academic and Student Affairs division. Because of this we plan to review possible alternatives to this fiscal relationship with the St Paul Technical College.

   While there were procedural errors, the responses received as a result of the RFP were evaluated in a fair and objective manner in order to select the response that would best meet the needs of MnSAT. The contract was awarded to the vendor providing the best solution to the objectives as outlined in the RFP.

The process followed for this contract is in no way representative of the contracting procedures routinely followed by the MnSCU system office. However, to reduce the risk of it happening again, we plan to revise system office contracting procedures. Some of the planned changes will directly address the issues that you have raised. They are:

- Whenever we expect that a contract will result in equipment purchases in excess of $25,000, sealed bids will be required. If the equipment is an integral part of a larger proposal, we will require that either the successful vendor or MnSCU get sealed bids.

- The recommendation that system procedure 5.5.1 part 2 be amended to include the system office will be implemented. This will help ensure understanding of the entire process, from development through the review and award, including proper documentation.

- We plan to continue to seek input from the professional community when the contract deals with issues of a specialized nature and will do so through the use of a request for information (RFI) prior to development of the RFP. Responsible individual – Rick Ellefson, system office business manager.

5. **Recommendation**: The system office should develop policies and procedures to periodically inventory fixed assets and segregate the incompatible duties in the MIS unit.

   Response: We concur. We will adopt procedures to maintain the equipment inventory and for periodic physical inventories. We are in the process of updating the fixed asset inventory system component of the MnSCU accounting system. Once this is updated we will then complete a fixed asset inventory. We will also eliminate the update security access to the inventory management system currently held by the MIS staff person. Responsible individual - Rick Ellefson, system office business manager.