Agricultural Utilization Research Institute

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Financial Audit
For the Three Fiscal Years Ended September 30, 1998

September 1999

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Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

99-52

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SUMMARY

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Agricultural Utilization Research Institute

Financial Audit
For the Three Fiscal Years Ended September 30, 1998

Public Release Date: September 30, 1999 No. 99-52

Background

The Minnesota Legislature established the Agricultural Utilization Research Institute as a nonprofit corporation in 1989. The institute promotes the establishment of new products and product uses and the expansion of existing markets for the state's agricultural commodities and products. The institute is governed by an 11-member board of directors. The board appoints an executive director to administer the institute. Edgar Olson has served as executive director since July 1997.

Audit Scope and Conclusions

We focused our audit on three specific areas: the overall financial management of the institute, project funding, and payroll. Generally, the institute designed and implemented internal controls to provide reasonable assurance that it safeguarded assets. However, the institute did not take a periodic inventory of its fixed assets. In addition, the institute did not deposit cash receipts timely and did not properly secure the balance in one bank account.

Except as noted below, for the items tested, the institute complied with applicable finance related legal provisions and policies established by its governing board. We noted two discrepancies between the institute's bylaws and Minn. Stat. Section 116O.09 and one discrepancy within the bylaws themselves. In addition, the institute disbursed project funds to clients before ensuring the appropriate project reports had been filed and did not comply with the loan collection provisions of its accounts receivable policy.

The institute properly compensated its employees in accordance with board policy. In addition, the institute appropriately withheld and contributed the proper amounts for its employee retirement and deferred compensation plans, other employee benefit plans, and taxes withheld. However, the institute did not adequately separate the personnel, payroll, and bank reconciliation processes.

In its audit response, the institute indicated it is taking corrective action to resolve the audit issues raised. However, the institute believed its bylaws were in compliance with Minnesota Statute.

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

Ms. Julie Bleyhl, Chair
Agricultural Utilization Research Institute Board of Directors

Members of the Agricultural Utilization Research Institute Board of Directors

Mr. Edgar Olson, Executive Director
Agricultural Utilization Research Institute

We have audited selected activities of the Agricultural Utilization Research Institute for the three years ended September 30, 1998, as further explained in Chapter 1. Our audit scope focused on the overall financial management of the institute, project funding, and payroll. We emphasize that this has not been a complete audit of all programs of the Agricultural Utilization Research Institute.

We conducted our audit in accordance with *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. The standards also require that we design the audit to provide reasonable assurance that the Agricultural Utilization Research Institute complied with the provisions of laws, regulations, contracts, and grants significant to the audit. Management of the Agricultural Utilization Research Institute 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 Agricultural Utilization Research Institute. This restriction is not intended to limit the distribution of this report, which was released as a public document on September 30, 1999.

James R. Nobles
Legislative Auditor

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: July 27, 1999

Report Signed On: September 24, 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
Thomas Donahue, CPA	Audit Manager
Laura Peterson, CPA	Team Leader
Steve Johnson, CPA	Senior Auditor

Exit Conference

We discussed the audit report findings and recommendations with the following representatives of the Agricultural Utilization Research Institute at an exit conference on September 17, 1999:

Julie Bleyhl	Chair, Agricultural Utilization Research Institute
Edgar Olson	Executive Director
Teresa Spaeth	Financial Officer

Chapter 1. Introduction

Laws of 1989, Chapter 350, Article 7, established the Agricultural Utilization Research Institute as a nonprofit corporation. The institute promotes the establishment of new products and product uses and the expansion of existing markets for the state's agricultural commodities and products.

Minn. Stat. Section 116O.09 established a nine-member board, which includes two members of the Legislature and representatives of statewide farm organizations, agribusiness, and commodity promotion councils. Currently an 11-member board of directors governs the institute. As discussed in Chapter 2, Finding 4, the institute's bylaws provide for an 11-member board. The board is responsible for establishing agricultural utilization research priorities and awarding various grants and other financial assistance. The board of directors appoints an executive director to administer the institute. Edgar Olson has served as executive director since July 1997. The institute's main office is in Crookston on the University of Minnesota campus. There are four regional offices located in Crookston, Marshall, Morris, and Waseca, as well as a field office in St. Paul.

The institute's mission is to foster long-term economic benefit through increased business and employment opportunities to rural Minnesota through:

- the identification and creation of new markets and the expansion of existing markets for new or existing commodities, ingredients, and products;
- the development of more energy efficient, natural resource saving production practices; and
- the development of new uses or value improvements for Minnesota agricultural commodities.

To accomplish this mission, the institute designed programs to bring new products to the marketplace. These programs include initial product assessments, new markets, pesticide reduction options, and applied research services. We further describe these programs in Chapter 3.

The institute's major source of funding comes from the State of Minnesota. In 1995, the Legislature appropriated $4.33 million to the institute for each of fiscal years 1996 and 1997 operations. Of the $4.33 million, $200,000 was allocated each fiscal year for hybrid tree management research and implementation. In 1997, the Legislature appropriated $4.42 million for fiscal year 1998. This appropriation allocated $200,000 for hybrid tree management and another $90,000 for a community-based youth program.

Agricultural Utilization Research Institute

Each year the institute hires an independent CPA firm to audit its financial statements. Table 1-1 shows summarized information from the institute's Statement of Financial Position as of September 30, 1998.

Table 1-1
Statement of Financial Position
As of September 30, 1998

Assets	
Cash and Cash Equivalents	$1,836,556
Restricted Cash	684,213
Investments	2,726,101
Furniture and Equipment (net of depreciation)	1,721,795
Other Assets	641,896
Total Assets	$7,610,561
Liabilities:	
Accounts Payable	$ 651,376
Net Assets:	
Unrestricted:	
Board Committed **(1)**	$4,029,855
Operations	785,011
Fixed Assets	1,721,795
Total Unrestricted	$6,536,661
Temporarily Restricted-Committed Projects **(2)**	422,524
Total	$6,959,185
Total Liabilities and Net Assets	$7,610,561

(1) The institute's Board of Directors designated a portion of the organization's unrestricted net assets to reflect various agreements the institute made to fund board approved projects and with Minnesota State Colleges and Universities to provide financial assistance for the construction or renovation of facilities. The board also designated a portion of the organization's unrestricted net assets for a marketing study and equipment purchases.

(2) The institute receives funding from the State of Minnesota and various private organizations, which is to be used for specific projects. This amount represents funds not yet spent for the Pesticide Reduction Option ($128,843), Hybrid Poplar ($233,714), and Urban Youth ($59,967) programs.

Source: September 30, 1998, Agricultural Utilization Research Institute audited financial statements.

Chapter 2. Financial Management

Chapter Conclusions

Generally, the Agricultural Utilization Research Institute designed and implemented internal controls to provide reasonable assurance that it adequately safeguarded assets. However, as discussed in Chapter 4, Finding 7, the institute did not adequately separate the personnel, payroll, and bank reconciliation functions. In addition, the institute did not take a periodic inventory of its fixed assets. Finally, the institute did not deposit cash receipts on a timely basis and did not properly secure the balance in one bank account.

For the items tested, the institute complied with applicable finance-related legal provisions and policies established by its governing board. However, we noted two discrepancies between the institute's bylaws and Minn. Stat. Section 116O.09 and one discrepancy within the bylaws themselves.

The Agricultural Utilization Research Institute receives the majority of its funding for operations from state appropriations. In addition, the institute receives income from its investment portfolio. The institute has two main checking accounts, one for payroll expenses and another for general operations. In addition to the checking accounts, the institute has seven investment accounts. The investment funds are held in money markets, certificate of deposits, and bonds. As of September 30, 1998, the institute had $2.7 million in investments.

Each quarter the institute requests one fourth of its annual appropriation from the Minnesota Department of Finance. The institute invests the appropriation until the funds are needed for disbursement. As funds are needed to pay for salaries, general operations, and project payments, the institute transfers funds from the investment accounts to the checking accounts.

The institute used the accounting software Great Plains Dynamics to track its financial activities. During the audit period, the institute used the Macintosh version of the accounting software and used the general ledger and accounts payable modules. Beginning in the fall of 1998, the institute converted to the IBM version of Great Plains Dynamics and added the purchasing, accounts receivable, project management, bank reconciliation, and financial statement compilation modules. During the audit period, the institute used an outside vendor to provide payroll services to account for payroll expenses and to compensate employees.

Minn. Stat. Section 116O.09 outlines the authority the board has to promote the establishment of new products and product uses and the expansion of existing markets for the state's agricultural commodities and products. It also requires the board of directors to approve all expenditures greater than $25,000. The board of directors delegated to the executive director the authority for decisions relating to the general management and control of the business and affairs of the institute. Some of these duties include:

- administering the affairs of the institute according to the policies of the board of directors,
- setting compensation, hiring, and discharging of all employees within the limits and policies of the board,
- having responsibility to prepare, submit, and maintain the records of the institute, and
- submitting budgets along with supporting documentation.

The institute's executive director, accounting staff, directors, managers, and scientists work together to develop the annual financial budget. The executive director presents the budget to the board of directors for approval. The financial officer provides monthly reports to division directors for their review and analysis.

An independent accounting firm audits the financial statements of the institute on an annual basis. The accounting firm issued unqualified opinions on the institute's financial statements for fiscal years 1996 through 1998.

Audit Objectives and Methodology

Our review of the Agricultural Utilization Research Institute's overall financial management focused on the following questions:

- Did the institute design and implement internal controls to provide reasonable assurance that it adequately safeguarded assets?

- Did the institute comply with applicable finance-related legal provisions and policies established by its governing board?

To answer these questions, we interviewed staff to gain an understanding of the current internal controls at the institute. We reviewed users' security over access to the accounting system. In addition, we reviewed the institute's cash management process and supporting documentation for selected financial transactions. Finally, we verified the institute received board approval for expenses greater than $25,000.

Conclusions

The Agricultural Utilization Research Institute designed and implemented internal controls to provide reasonable assurance that it adequately safeguarded assets. However, as discussed in Chapter 4, Finding 7, the institute did not adequately separate the personnel, payroll, and bank reconciliation functions. In addition, as discussed in Finding 1, the institute did not take a periodic inventory of its fixed assets. We noted in Finding 2 that the institute did not deposit cash receipts in a timely manner. Also, as explained in Finding 3, the institute did not properly secure the balance in one bank account. For the items tested, the institute complied with applicable finance-related legal provisions and policies established by its governing board. However, as discussed in Finding 4, we noted two discrepancies between the institute's bylaws and Minn. Stat. Section 116O.09 and one discrepancy within the bylaws themselves.

Agricultural Utilization Research Institute

1. The institute did not take a periodic inventory of its fixed assets.

The Agricultural Utilization Research Institute had not taken a physical inventory of its fixed assets since 1996. The institute capitalizes asset purchases of $2,000 or more. As of September 30, 1998, the institute had $1,721,795 in fixed assets net of depreciation. These fixed assets include office equipment and furniture, lab equipment, off-site equipment, capital improvements, and computer software. Assets are located throughout the institute's five locations and some assets change locations depending on operational needs. The institute accounts for its fixed asset inventory on a computer spreadsheet. However, by not periodically verifying the existence of the assets on the spreadsheet, the institute risks not detecting lost or stolen fixed assets.

Recommendation

- *To ensure assets are appropriately accounted for, the institute should periodically take a physical inventory of its fixed assets and verify the existence of recorded items.*

2. The institute did not make timely deposits of its cash receipts.

The Agricultural Utilization Research Institute did not make timely cash deposits. During the three fiscal years ended September 30, 1998, the average deposit was $21,541 and the average number of days between deposits was approximately four days. From October 1, 1998, to the end of the audit field work, the average deposit increased to $27,488, and the average days between deposits increased to seven days. To calculate the average deposit, we excluded the larger state appropriation deposits. The majority of the deposits consist of loan repayments. All receipts come into the Crookston office. By not depositing receipts on a timely basis, the risk of funds being lost or stolen increases. In addition, the institute loses interest by not depositing receipts timely.

Recommendation

- *The institute should review its cash management practices and deposit its cash receipts on a more timely basis.*

3. The institute did not adequately secure the balance in one checking account.

The Agricultural Utilization Research Institute did not adequately secure the balance in its general operating checking account. The average balance in the checking account was $228,276 for the three fiscal years ended September 30, 1998 and increased to $302,291 from October 1, 1998, to the end of the audit field work. The institute transferred funds from its investment accounts to the general operating checking account as funds were needed. The institute managed the bank balance by maintaining the cash balance per the accounting system at $100,000. Generally, the process of checks clearing the bank leaves the actual bank balance higher than the balance per the accounting system. Because the institute is a nonprofit corporation rather than a governmental entity, banks are unable to pledge collateral against funds in excess of the

$100,000 federal insurance. Therefore, the risk of loss increases when the bank balance exceeds $100,000.

Recommendation

- *The institute should manage the cash flow in its checking account to ensure the average bank balance does not exceed $100,000.*

4. The institute's bylaws were not consistent with Minn. Stat. Section 116O.09 and contained one discrepancy within the bylaws themselves.

We found two discrepancies between Minn. Stat. Section 116O.09 and the Agricultural Utilization Research Institute bylaws.

- Minn. Stat. Section 116O.09, Subd. 1a, states that the institute has nine members on the board of directors. However, Section 4.1 of the bylaws states there are 11 members. During the audit period, the institute had 11 members. The bylaws show three representatives of agribusiness while the statute allows for two. In addition, the bylaws show four representatives from the commodity promotion council while the statute allows for three.

- Minn. Stat. Section 116O.09, Subd. 8, states that the board of directors elects a chair annually. However, Section 4.4 of the bylaws states that the chair is elected biennially, while Section 5.1 states that the officers, including the chair, are elected annually. During the audit period, the board elected officers annually.

The institute risks not complying with Minnesota Statutes when its bylaws contradict the statutes.

Recommendation

- *The institute should update its bylaws to agree with Minnesota Statute or seek a legislative change to the statutory provisions.*

Chapter 3. Project Funding

Chapter Conclusions

The Agricultural Utilization Research Institute disbursed project funds to clients before ensuring the appropriate project reports had been filed. In addition, the institute did not comply with the loan collection provisions of its accounts receivable policy. Except for these issues, for the items tested, the Agricultural Utilization Research Institute complied with grant and loan policies and provisions established by the board.

The institute provides technical expertise and financial assistance for new product research, development, and commercialization in four program areas: initial product assessments, new markets, pesticide reduction options, and applied research services. Financial assistance is provided to clients either through direct loans or grants. The majority of assistance has been in the form of loans. During the audit period, the institute approved $2,833,096 for various projects.

The Initial Product Assessments Program offers funding to Minnesota businesses for short-term projects in the areas of technical and financial feasibility. The institute designed the program to help determine if projects are feasible and worth further investment. This program tests the technical soundness and quality of new or improved processes or technologies and new or value-added food or nonfood agricultural products. If a product or technology already exists, the institute may fund a study to examine the commercial potential.

The New Markets Program offers commodity and farm organizations with assistance in advancing the research and development of Minnesota agricultural commodities. The institute provides funds for feasibility studies, research and development work, building export capacities, addressing public policy, research for business issues impacting commodity utilization, and other activities related to finding and developing new uses and markets for Minnesota farm goods.

The Pesticide Reduction Options Program funds research and demonstration projects intended to reduce the use of petroleum-based products in production agriculture. The specific objectives of this program include:

- research or demonstration of cultural, biological, or mechanical control practices, integrated-pest-management methods, or agricultural chemical spill-site remediation;
- substitution of renewable resource-based pesticides in agricultural production;
- incorporation of pesticide-reduction information into pesticide-use decision aids;
- promotion of safe on-farm pesticide use practices; and
- development of pesticide use recommendations for alternative crops.

Agricultural Utilization Research Institute

Finally, the institute's applied research services complement the technical and financial assistance given to clients. The institute's scientific staff works with agri-businesses, university scientists, federal labs, and commodity groups to access new technology and link it with commercial partners. Focus areas include:

- alternative fuels, fats, and oils,
- food products/cereals,
- meat products,
- fiber,
- waste utilization, and
- aquaculture.

The institute has a team at each facility that assists individuals and organizations interested in participating in one or more of the programs. The team members, including both administrative and technical staff, determine the feasibility of a project. The team leader is authorized to approve client projects and commit institute funds up to $15,000. The executive director must approve projects ranging from $15,000 to $25,000. The board must approve all projects over $25,000. The institute requires clients receiving financial assistance to contribute at least half of the project costs. Once a project is approved, the institute initiates a written agreement.

Essentially, the institute's funding of projects, either under a grant or loan agreement, is in the form of a line of credit. The institute provides financial assistance through reimbursements of costs. Clients must have provided the institute's team leaders with evidence that applicable costs were incurred before the main office in Crookston would reimburse the client. In addition, the contracts require clients to submit quarterly reports to the institute. These reports outline the project's progress and expenses incurred to date. Clients are obligated to repay the loan amounts over varied periods up to ten years and at an interest rate of six percent. However, according to the institute's September 30, 1998, audited financial statements, net project receivables were valued at $134,898. The estimated allowance for uncollectible projects aggregated approximately $2.6 million at September 30, 1998. The board must approve all debt write-offs of $25,000 or more. During the audit period, the board authorized the write-off of six loans totaling $496,022.

Audit Objective and Methodology

Our review of the Agricultural Utilization Research Institute's grants and loans focused on the following question:

- Did the institute comply with grant and loan policies and provisions established by the board?

To answer this question, we interviewed staff to gain an understanding of the current internal control structure related to the grants and loans. We reviewed source documentation within the grant and loan files to determine if the institute properly authorized projects, clients submitted the required reports and evidence of expenses incurred, and the institute properly filed a security interest in equipment purchased by the client. We reviewed the institute's method of making project payments and applying cash receipts to loan balances and depositing the cash receipts into its bank account. Finally, we verified that the institute received board approval for those project payments and loan forgiveness transactions greater than $25,000.

Conclusion

The Agricultural Utilization Research Institute disbursed project funds to clients before ensuring the appropriate project reports had been filed, as noted in Finding 5. In addition, as discussed in Finding 6, the institute did not comply with the loan collection provisions of its accounts receivable policy. Except for these issues, for the items tested, the Agricultural Utilization Research Institute complied with grant and loan policies and provisions established by the board.

5. PRIOR FINDING NOT RESLOVED: The institute disbursed project funds to clients before ensuring that the appropriate project reports had been filed.

The institute did not ensure that clients submitted required quarterly project reports before it processed additional payments to the clients. Project contracts specifically state that "Any recipient who fails to submit their quarterly report within 30 days of the deadline will be placed on suspension until the report is received. Any expenditures incurred during the suspension period will be disallowed." However, clients continued to submit project invoices to the institute for payment even though a quarterly report had not been filed. The institute continued to reimburse clients based on the invoices submitted. We noted that the institute did not have a mechanism in place to identify those clients who did not submit timely quarterly reports. As a result, the institute may have paid for costs that would have otherwise been disallowed under the project contract.

Efficient monitoring of project reports is a key control to ensure that projects are proceeding properly and payments meet the matching requirements and are for allowable project expenditures. We did note redundancies in the reporting process. The institute required some clients to submit the same documentation of expenditures three times, first as a reimbursement for loan or grant proceeds, then as an expenditure on a quarterly report, and finally as an expenditure on a final report. This redundancy may have contributed to the institute's difficulty in obtaining the required reports.

Recommendations

- *The institute should review its client reporting requirements to determine if the process can be simplified while still providing needed documentation to ensure compliance with the project contract.*

- *The institute should ensure clients submit required reports before it processes project payments.*

6. The institute did not adequately track its account receivables resulting in non-compliance with its Accounts Receivable Policy.

We reviewed 15 project loan files and noted that 4 projects were current, 5 projects were in bankruptcy, and 6 projects were in arrears. For all six projects in arrears, the institute did not follow the loan collection provisions of its accounts receivable policy. The policy directs the institute to contact, and when appropriate, to initiate collection action against clients whose loan repayments are more than 120 days overdue. Currently, institute staff manually review each loan folder to determine whether the client's loan repayments were in arrears. However, for the six accounts in arrears we tested, we found no evidence that the institute had initiated collection action.

The institute did not have a comprehensive system in place that would allow it to track or monitor its accounts receivables on a timely basis. During the audit period, the institute maintained its account receivables on a computer spreadsheet. Because of certain limitations, the accounting software was unable to produce an aging of receivables report on a timely basis. As a result, the institute was not able to effectively manage its receivables.

The institute needs to produce a timely report of its aged accounts receivables in order to effectively begin collection procedures on those accounts that are 120 days or more overdue.

Recommendations

- *The institute should develop an accounts receivable system that will track or monitor and age its receivables on a timely basis.*

- *The institute should comply with established policies for monitoring loan repayments.*

Chapter 4. Payroll

Chapter Conclusions

The Agricultural Utilization Research Institute properly compensated its employees in accordance with board policy. In addition, the institute appropriately withheld and contributed the proper amounts for its employee retirement and deferred compensation plans, other employee benefit plans, and taxes withheld. However, the institute did not adequately separate the personnel, payroll, and bank reconciliation functions.

The Agricultural Utilization Research Institute employs approximately 30 employees at its five locations. Institute employees are not state employees but may participate in state retirement, deferred compensation, insurance, and other plans that apply to state employees. The executive director sets compensation and hires and discharges employees within the limits and policies established by the board.

During fiscal year 1998, the institute's payroll costs were approximately $2 million. The institute uses an outside vendor to provide payroll services. Those services include processing new employee appointment information, salary increases, initiating direct deposits to employee accounts, issuing W2 forms to institute employees, and providing the institute with biweekly and quarterly payroll reports.

Audit Objectives and Methodology

Our review of the Agricultural Utilization Research Institute's payroll focused on the following questions:

- Did the institute compensate its employees in accordance with the payroll policies and provisions established by the board?

- Did the institute appropriately withhold and contribute the proper amounts for its employee retirement and deferred compensation plans, other employee benefit plans, and taxes withheld?

To answer these questions, we interviewed staff to obtain a general understanding of the control structure over the personnel and payroll processes. We also analyzed payroll transactions and reviewed personnel files to determine that pay increases, new hires, promotions, and severance payments were properly authorized and in accordance with board policy. Finally, we reviewed documentation to ensure employee withholdings were properly transferred to the appropriate organizations.

Conclusions

The Agricultural Utilization Research Institute properly compensated its employees in accordance with board policy. In addition, the institute appropriately withheld and contributed the proper amounts for its employee retirement and deferred compensation plans, other employee benefit plans, and taxes withheld. However, as discussed in Finding 7, the institute did not adequately separate the personnel, payroll, and bank reconciliation functions.

7. The institute did not adequately separate the personnel, payroll, and bank reconciliation functions.

The Agricultural Utilization Research Institute did not adequately separate duties related to payroll. One employee electronically transmitted new employee appointment information, salary increases, direct deposit information, and other personnel information to the institute's payroll service company. This employee also transmitted biweekly payroll transactions, including number of hours employees worked and bonus and severance payments to the payroll service company. In addition, the employee received and reviewed the biweekly payroll reports provided by the payroll service company and reconciled the payroll checking account. By not separating the personnel, payroll, and bank reconciliation processes, the risk of errors and irregularities increases.

Recommendation

- *The institute should separate the personnel, payroll, and bank reconciliation functions.*

Status of Prior Audit Issues
As of July 27, 1999

Most Recent Audits

Legislative Audit Report 94-44, issued in September 1994, covered the two fiscal years ended September 30, 1993. This report included a review of reserves and investments, payments to projects, and payroll. This report contained two audit findings. In the first finding, the institute did not adequately control its investment account. The institute resolved the majority of this finding, but is still in the process of separating duties over the authorization of investment transactions and reconciling of the investment accounts to the general ledger. In the second finding, the institute disbursed payments for projects without first receiving the required quarterly reports. Chapter 3, Finding 5, shows that this finding was not resolved.

Other Audit Coverage

The Agricultural Utilization Research Institute employed an independent CPA firm to audit its annual financial statements. For fiscal years 1996 through 1998, the institute hired Brady, Martz & Associates P.C. The institute received unqualified opinions on its fiscal years 1996, 1997, and 1998 financial statements. Brady Martz & Associates P.C. brought the following issues to management's attention for fiscal year 1998:

- The institute did not consistently reconcile all of its bank accounts.
- The institute did not request from the State of Minnesota all funds for 1998.

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. 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 of Minnesota, any quasi-state organizations, such as Metropolitan agencies or the State Agricultural Society, the state constitutional officers, or the judicial branch.

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AURI

AG INNOVATIONS

Agricultural Utilization Research Institute

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September 23, 1999

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

Dear Mr. Nobles,

Enclosed, please find the Agricultural Utilization Research Institute reply to the audit report of the three years ended September 30, 1998. The response reflects discussions held in your office on September 17, 1999, and attended by Ms. Gudvangen, Mr. Donahue, Ms. Peterson and Mr. Johnson of your staff as well as Ms. Bleyhl (AURI Board Chair), Ms. Spaeth (Financial Officer) and myself.

As outlined in our discussions with your staff, the management and staff at AURI spent considerable time in fiscal year 1999 evaluating its programs and services. As a result of this evaluation, the loan program was discontinued, and many program and service enhancements were made. In addition, in an effort to provide better management information, as well as provide improved customer service, an extended project and accounting software system was implemented and delivered on an institute-wide basis. Given the number of recent changes, this was certainly an excellent time for your staff to review our internal controls and make suggestions for improving the process. Further, I appreciate the professional dedication shown by your staff in both understanding our past procedures and making recommendations to improve our new ones.

Finally, your staff, including Mr. Donahue, Ms. Peterson and Mr. Johnson, provided very valuable input in implementation of our new processes. I found their suggestions to be reasonable and sound, and many of these have been incorporated into our improved programs. Thank you and your staff for the professional effort that was displayed in conducting the audit of the Agricultural Utilization Research Institute. If I can be of further assistance to you, please do not hesitate to contact me.

Sincerely,

Edgar Olson
Executive Director

Serving Minnesota with regional offices in Waseca, Morris, Marshall, and Crookston

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Legislative Audit of the Agricultural Utilization Research Institute

Response to the Audit Report for Field Work Ended July 27, 1999

1. *To ensure assets are appropriately account for, the institute should periodically take a physical inventory of its fixed assets and verify the existence of recorded items.*

   AURI plans to add fixed asset management software to it already growing suite of accounting and project software in fiscal year 2000. This program will track location, depreciation and current value of all assets. As part of the implementation process, the institute will be conducting a physical inventory of its fixed assets. The software has been purchased and will be installed after the fiscal year 1999 audit. Once installation and training is complete, the management team of AURI will begin the process of planning and conducting a physical count of the assets.

2. *The institute should review its cash management practices and deposit its cash receipts on a more timely basis.*

   The institute has changed its internal handling of deposits. In the past deposits were made once each week, now deposits are being made twice weekly. This change in policy will be reflected in the updated AURI policy manual in fiscal year 2000.

3. *The institute should manage the cash flow in its checking account to ensure the average bank balance does not exceed $100,000.*

   The institute has made plans to incorporate the use of a second checking account to secure funds. This account will be used for checks written for $15,000 or greater. These funds will be immediately transferred to the payee bank to ensure that the institute's balance does not exceed the $100,000 FDIC insurance limit. In addition, the finance department will be more closely evaluating daily cash requirements and bank balances to safeguard the institute's cash balances.

4. *The institute should update its bylaws to agree with Minnesota Statute or seek a legislative change to the statutory provisions.*

   AURI feels it is in compliance on this issue.

5. *The institute should review its client reporting requirements to determine if the process can be simplified while still providing needed documentation to ensure compliance with the project contract.*

   The institute should ensure clients submit required reports before it processes project payments.

   The management staff of AURI carefully considered all factors involved in the reporting and collection process of its partnership and initial product assessment loan program. In fiscal year 1999, the decision was made to eliminate the loan program. As such, many of the identified reporting requirement issues have been mitigated.

With regard to current AURI programs, the reporting requirements were amended to remove redundancies and ensure compliance with guidelines. The disbursement process was simplified to include a 50% reimbursement upon submittal of paid invoices by the customer. For amounts over $2,000, AURI will issue a two-party check (customer and vendor) for an unpaid invoice. In all cases, the disbursement request form was amended to document compliance with the guidelines. Copies of the new reporting and compliance documentation reports will be supplied to the Office of the Legislative Auditor under separate cover.

In order to ensure that documentation is properly in place, the institute will place electronic "holds" on customer project accounts until the required paperwork is in place. These holds prevent checks from being printed to the customer until the documentation is received.

6. *The institute should develop an accounts receivable system that will track or monitor and age its receivables on a timely basis.*

   The institute should comply with established policies for monitoring loan repayments.

   As part of the implementation of the Accounts Receivable and Project accounting modules, all loan balances, customer payments, disbursements and time and effort are being recorded on an individual customer basis in the accounting software system. From this information, current loan balances and payments are now accessed on a real-time basis from field office staff that are responsible for collection efforts. Due to a software limitation, AURI is still researching a mechanism to age the payments that are due. The management staff expects this situation to be resolved in fiscal year 2000. Further, loan balances and payments are no longer being tracked on spreadsheet software and then moved to the general ledger.

   Also as part of the management team's review of AURI's programs, the team is reviewing and updating its policies regarding collections of loan payments. The management staff has found that the current policy does not meet the needs and objectives of the institute, and will be making recommendations to the Board of Directors on changes needed in the policy. All recommendations of the Office of the Legislative Auditor will be taken into consideration when submitting the policy amendments to the Board for approval.

7. *The institute should separate the personnel, payroll, and bank reconciliation functions.*

   The responsibilities of this function have now been appropriately divided between the Executive Coordinator and the Financial Officer. These changes have been reviewed with the staff of the Office of the Legislative Auditor, and the management teams feels the institute is now in compliance with proper internal control procedures.