

O L A

OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Financial Audit Division Report

Minnesota State Academies
July 1, 2000, through June 30, 2004



Financial Audit Division

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Members of the Minnesota State Academies Board

Ms. Linda Mitchell, Administrator
Minnesota State Academies

We have audited the Minnesota State Academies for the period July 1, 2000, through June 30, 2004. Our audit scope included grant revenue, employee payroll, administrative expenditures, and banking and imprest cash activities. Our objectives focused on a review of the academies' internal control over these financial activities and compliance with applicable legal provisions.

We found that the academies had significant control weaknesses over banking and imprest cash activities and the purchasing process. The academies' internal controls did not ensure an adequate safeguarding of assets relating to those activities or compliance with numerous finance-related legal provisions. Those weaknesses were part of 13 findings in this report.

The Report Summary highlights our overall audit conclusions. The specific audit objectives and conclusions for each area are contained in the individual chapters of this report.

We would like to thank staff from the Minnesota State Academies for their cooperation during this audit.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: April 8, 2005

Report Signed On: December 19, 2005

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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
David Polisen, CPA, CISA, CFE	Audit Manager
Susan Kachelmeyer, CPA, CISA	Auditor-in-Charge
Marisa Isenberg	Auditor
Kelly Olson	Auditor

Exit Conference

We discussed the results of the audit with the following staff of the Minnesota State Academies and the Department of Finance at an exit conference on December 8, 2005:

Minnesota State Academies:

Linda Mitchell	Administrator
Tom Schoenbauer	Accounting Supervisor
Rick Caron	Accountant
Patty Rux	Purchasing/Student Accounts

Department of Finance:

Lisa Mueller	Executive Budget Officer
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Report Summary

Overall Conclusion:

The Minnesota State Academies did not adequately control local bank account and imprest cash activities. In addition, the academies did not comply with numerous finance-related legal provisions relating to the purchasing process.

Key Findings:

- The academies did not adequately segregate key duties for several types of financial transactions. (Finding 3, page 9, Finding 10, page 18, and Finding 11, page 21)
- The academies did not maintain appropriate supporting documentation for many local bank account transactions. (Finding 2, page 8 and Finding 5, page 11)
- The academies did not comply with the Department of Finance's and internal procedures relating to imprest cash bank accounts. (Finding 4, page 10)
- The academies received excess grant revenue because of inaccurate reporting of some salary information to the Department of Education. (Finding 7, page 14)
- The academies did not follow the state's procurement guidelines. (Finding 1, page 7 and Finding 11, page 21)

The report contained 13 findings related to internal control and legal compliance. The academies resolved three of four prior audit findings. The recommendations for the fourth finding were partially implemented, and the issue is included in Finding 2, page 8.

Audit Scope:

Audit Period:

July 1, 2000, through June 30, 2004

Programs Audited:

- Banking and Imprest Cash Activities
- Grant Revenue
- Employee Payroll Expenditures
- Administrative Expenditures

Agency Background:

The mission of the Minnesota State Academies is to promote the highest level of self-sufficiency possible for the deaf/hard of hearing and blind/visually impaired students in Minnesota. The academies consist of two separate public schools. They educate enrolled/non-enrolled students or support other public schools to educate students to develop social skills, leadership skills, and specialized skills, such as sign language and Braille.

The academies' operations are funded through state appropriations and grants. During our audit period, state appropriations averaged about \$10.5 million per year, and grants averaged about \$1.8 million.

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Chapter 1. Introduction

The Office of the Legislative Auditor selected the Minnesota State Academies (MSA) for audit based on an annual assessment of state agencies and programs. We used various criteria to determine the entities to audit, including the size and type of each agency's financial operations, length of time since the last audit, changes in organizational structure and key personnel, and available audit resources.

Agency Overview

The academies were established in 1863 and are statewide public schools that provide education and related services to students from preschool to age 21 who are deaf, hard of hearing, blind, or visually impaired, including those with multiple disabilities. The Minnesota State Academies operates two separate campuses located about one mile apart from each other in Faribault, Minnesota; the Minnesota State Academy for the Deaf (MSAD) and the Minnesota State Academy for the Blind (MSAB). The decision to attend MSA is made by a planning team made up of parents, staff from the district of residence, and MSA staff. The academies educate students or support other public schools to educate students to develop social skills, leadership skills, and specialized skills, such as sign language and Braille. During the school year, about 200 students attend the academies. Linda Mitchell is the MSA superintendent.

The academies combine all accounting functions in one business office, located on the Minnesota State Academy for the Deaf (MSAD) campus. The accounting staff includes one accounting supervisor and three accountants. The academies also have one person from the human services unit involved in receipt processing to provide a segregation of duties.

The academies receive state appropriations and grant revenues from school districts and the state Department of Education to fund the general operations of the schools. Table 1-1 summarizes MSA's financial activities for the four fiscal years ended June 30, 2004.

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Table 1-1
Minnesota State Academies
Sources and Uses of Funds
By Budget Fiscal Year

	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
Sources:				
General Fund Appropriation	\$10,258,000	\$10,761,000	\$10,966,000	\$10,466,000
Less: Canceled or Reverted	(860)	0	(840,695)	(100,000)
State Grants ^(Note 1)	1,613,888	969,991	1,667,734	1,888,456
Federal Grants	219,813	205,179	238,540	243,779
Other Receipts	147,727	185,085	335,453	250,077
Balance Forward In	<u>1,536,496</u>	<u>1,530,060</u>	<u>1,819,483</u>	<u>1,543,834</u>
Total Sources	<u>\$13,775,064</u>	<u>\$13,651,315</u>	<u>\$14,186,515</u>	<u>\$14,292,146</u>
Expenditures and Other Uses:				
Payroll	\$ 9,826,273	\$10,055,830	\$10,623,898	\$10,722,015
Maintenance and Utilities	465,567	427,262	468,837	427,216
Professional/Technical Services	433,635	462,493	425,420	465,063
Supplies	624,306	337,360	459,279	411,227
Equipment	264,029	66,084	178,166	64,992
Other Administrative Expenditures	631,194	482,803	487,080	516,091
Balance Forward Out	<u>1,530,060</u>	<u>1,819,483</u>	<u>1,543,834</u>	<u>1,685,542</u>
Total Expenditures and Other Uses	<u>\$13,775,064</u>	<u>\$13,651,315</u>	<u>\$14,186,515</u>	<u>\$14,292,146</u>

Note 1: State grants in fiscal year 2002 were significantly lower because of the recapture of approximately \$438,000 in fiscal year 2000 overpayments.

Note 2: In addition to the amounts shown, the academies collected about \$210,000 annually from employees participating in a deferred compensation program and transferred those funds to the appropriate company based on the employees' directions.

Source: Minnesota Accounting and Procurement System (MAPS) as of January 2005.

Audit Approach

We conducted our audit in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we obtain an understanding of the academies' internal controls relevant to the audit objectives. We used the guidance contained in *Internal Control-Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission, as our criteria to evaluate controls. The standards also require that we plan the audit to provide reasonable assurance that the Minnesota State Academies complied with financial-related legal provisions that are significant to the audit. In determining the academies' compliance with legal provisions, we considered requirements of laws, regulations, contracts, and grant agreements.

To meet the audit objectives, we gained an understanding of the academies' financial policies and procedures. We considered the risk of errors in the accounting records and noncompliance with relevant legal provisions. We analyzed accounting data to identify unusual trends or significant changes in financial operations. We examined a sample of documentation supporting the academies' internal controls and compliance with laws, regulations, contracts, and grant provisions.

Chapter 2. Banking and Imprest Cash Activities

Chapter Conclusions

The Minnesota State Academies' internal controls did not provide assurance that local bank account receipts and disbursements were adequately safeguarded, accurately reported in the accounting records, and in compliance with applicable legal provisions and management's authorization. Our audit disclosed the following weaknesses:

- *The academies did not establish appropriate internal controls to safeguard its student athletic association funds, as discussed in Finding 1.*
- *The academies did not document its local activity transactions, as discussed in Finding 2.*
- *The academies did not adequately segregate duties for certain student activities, as discussed in Finding 3.*
- *The academies operated two local bank accounts without proper authorization or written procedures, as discussed in Finding 4. In addition, the Minnesota State Academies did not comply with imprest cash guidelines and did not properly deposit all of its receipts in the state treasury.*
- *The academies made inappropriate transfers among its state and local accounts, as discussed in Finding 5.*
- *Finally, the Minnesota State Academies did not document certain activities with related foundations, as discussed in Finding 6.*

Audit Objective

The primary objective of our audit of the Minnesota State Academies' banking and imprest cash activities was to answer the following questions:

- Did the academies' internal controls provide reasonable assurance that bank account and imprest cash financial activity was properly authorized and safeguarded, accurately reported in the accounting records, and in compliance with applicable legal provisions and management's authorization?
- For the items tested, did the academies comply with material finance-related legal provisions?

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Background Information

The academies used the state's accounting system (MAPS) and the state's treasury system to process transactions affecting its operations. In addition to the state treasury, the academies used three local bank accounts to process some of these transactions. The Department of Finance granted them authority to use these bank accounts to pay for incidental purchases and student payroll. The academies wrote checks out of these local accounts and recorded the transactions on MAPS.

The academies established four additional local bank accounts to process transactions affecting various student activities, such as students' personal funds, yearbook fees and sales, and athletic association fees and events. The academies used its own accounting system to record the transactions affecting these activities and established its own internal controls over these accounts, including reconciliations. The academies generally did not record these activities in MAPS.

Students enrolled at the Minnesota State Academy for the Deaf (MSAD) and the Minnesota State Academy for the Blind (MSAB) may deposit personal funds with the academies' business office and receive those funds either through weekly allowances or as needed. Personal checks and cash either come through the mail or are brought to the campus by the student. The MSAB sends checks received at its location via intercampus mail to the MSAD business office. A program staff member delivers any cash directly to the business office upon receipt. In addition, yearbook and student athletic association fees are collected at the beginning of the school year and given to the yearbook coordinator or athletic director.

Table 2-1 summarizes the transactions in the Minnesota State Academies' local bank accounts from June 30, 2003, through January 31, 2005.

Table 2-1
Summary of Local Bank Account Activity by Account
June 30, 2003 – January 31, 2005

	Balance as of June 30, <u>2003</u>	<u>Deposits</u>	<u>Withdrawals</u>	<u>Difference</u>	Balance as of January 31, <u>2005</u>
MSAB Student Account	\$ 1,191.82	\$12,505.74	\$12,947.56		\$ 750.00
MSAD Student Account	\$ 450.25	\$54,326.53	\$53,781.29		\$ 995.49
MSAB Current Expense Account	\$ 1,675.04	\$15,657.46	\$15,319.46		\$ 2,013.04
MSAD Current Expense Account	\$ 695.20	\$30,774.91	\$26,485.04		\$ 4,985.07
MSA Student Payroll Account	\$ 6,942.07	\$24,773.49	\$26,052.44		\$ 5,663.12
MSA Student Activity Account	\$28,729.63	\$56,638.31	\$63,418.32		\$21,949.32
MSA Student Athletic Account ¹	\$ 1,169.79	\$43,865.52	\$39,624.93	\$3,441.45	\$ 1,968.93

Note 1: The bank statement for December 2003 was not available.

Source: Monthly bank statements for June 30, 2003, through January 31, 2005.

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Current Findings and Recommendations

1. The academies did not establish appropriate controls to safeguard student athletic association funds.

From July 1, 2000, through January 31, 2005, the academies collected and spent approximately \$100,000 of student athletic association funds with little or no controls. The academies collected receipts from student fees, ticket sales from sporting events, donations, and concession stand sales and deposited these funds in a local bank account with little or no accountability for the activity. The academies could not produce documentation to support most of the transactions and allowed one individual complete control of athletic association financial activity. As a result, we could not verify that the academies used those funds for authorized purposes. We identified the following weaknesses:

- The academies did not establish appropriate procurement practices when expending athletic association funds. The athletic director had complete control of the procurement process. He did not use requisitions or purchase orders to document purchases and did not retain adequate supporting documentation for the transactions. We were given several large manila envelopes that contained documentation for student athletic association activities. However, the documentation was not organized, and we could not link all of the information to the actual purchases. Appropriate documentation should support the transaction amount and include evidence of authorization.
- The academies did not reconcile the student athletic bank account to ensure that the bank accurately recorded the deposits and checks to arrive at the ending account balance. The athletic director received and maintained all of the bank statements. We reviewed the monthly bank statements from May 2000 through January 2005. The academies could not locate two statements, and four others were missing cancelled checks. Nineteen of the bank statements had never been opened before we received them. Without periodic reconciliations, the academies have no way of knowing if all of the activity was properly recorded.

Additionally, the student athletic association account incurred about \$900 in bank service fees from May 1, 2000, through January 31, 2005. Because no one in the business office reviewed or reconciled the account, the academies were not aware of the charges. The athletic director was surprised at the amount of the fees and could not explain why these service fees were charged.

- The academies did not institute any safeguards for its cash receipts generated at student athletic events or through fundraising activities. On the day of a sporting event, the athletic director wrote a check to “cash” from the bank account to establish change funds for ticket sales and to purchase food and beverages for the concession stand. After the event, he deposited the monies collected. However, we could not determine the timeliness of the deposit, or if all of the receipts were deposited in the bank. The academies did not use sequentially numbered tickets for admission to the games and did not use a cash register or other methods to document the amount of concession stand

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sales. As a result, the academies could not verify that all cash collected was properly deposited and recorded in the accounting records. Similarly, the athletic director disbursed funds to purchase any items used for fundraising events, collected the money raised, and deposited the funds into the bank. The academies did not produce reports of income or expenditures for sporting or fundraising events, so no one independent of the process could review the activity for reasonableness.

The academies did not deposit student athletic receipts in the state treasury. *Minnesota Statutes* 2004, 125A.72 states that, “All receipts of any kind generated to operate student activities, including student fees, donations and contributions, and gate receipts must be deposited in the state treasury. The receipts are appropriated annually to the Minnesota State Academies for student activities purposes.” The academies need to establish an internal control structure to ensure that the student athletic and student activity accounts are free of errors or irregularities.

Recommendations

- *The academies should establish an internal control structure to ensure that no one individual has complete control of student athletic activity financial transactions.*
- *The academies should follow the state’s procurement policies for purchases made from the student athletic activity account.*
- *The academies should maintain documentation for its athletic activities and fundraising events, such as receipts, ticket stubs, or cash register tapes, and reconcile the supporting documentation to monies collected.*
- *The academies should deposit all student related monies in the state treasury and record all student related activity on MAPS.*

2. PRIOR FINDING NOT RESOLVED: The academies did not retain documentation to support deposits and withdrawals from student accounts.

The academies could not produce some student allowance sheets that supported funds withdrawn by students. The house parents at the academies collect the students’ weekly allowances from business office staff to distribute to the students. The house parents sign allowance sheets documenting the receipt of these funds. According to the academies’ policy, the student is also required to sign the allowance sheet, and the house parents should return the allowance sheets to the business office. We found that the house parents did not consistently return all of the signed allowance sheets to the business office for review. This increases the risk that allowances could be lost, stolen, or not properly recorded in the accounting records.

In addition, the academies did not retain proper documentation to support deposits made by parents into their child’s personal account. At the beginning of each school year, parents generally deposit some money into their child’s account to be used for personal expenses. The

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academies give the parents the top copy of a pre-numbered receipt and retain the bottom copy for its records. However, during registration, staff frequently altered the amounts on the retained copies by crossing out original amounts or using white correction fluid. This made it impossible to determine the amount originally received. In some cases the word “void” was written on the receipt even though it was obvious that money had been received from the parent. Without a clean copy of the transaction, we could not verify that the academies properly deposited all of the money it received.

The academies did not consistently give parents receipts for student deposits received during the school year. Student deposits that were received at the Minnesota Academy for the Blind (MSAB) campus were delivered to the accounting unit on the Minnesota Academy for the Deaf (MSAD) campus. Unless a parent requested a receipt, the academies returned the top copy from the receipt to MSAB where it was filed until the end of the school year and then thrown away. Receipts were provided to students on the MSAD campus. However, no one independent of the collection process reviewed this activity.

Without proper documentation to support these transactions, we could not determine if the academies deposited all funds received or properly disbursed student withdrawals.

Recommendations

- *The academies should ensure that all student allowance and withdrawal forms are signed and returned to the business office as required in the academies’ policies.*
- *The academies should retain accurate documentation of all student deposits and should not alter copies of receipts.*

3. The academies did not adequately segregate duties for certain student activities.

The academies did not segregate duties related to the collection of student account deposits during registration days. During most of the school year, one individual collected, recorded, and made the deposits for student account receipts, and a separate individual was in charge of all the disbursements made from that account. However, due to the heavy volume at the beginning of each school year, the individual who made the disbursements also collected some receipts. This results in poor controls, because one person has access to both the collecting and disbursing functions.

The academies also did not segregate duties for the yearbook and student athletic association activities. The academies assigned a coordinator to each activity and allowed them complete control of the related financial transactions. The academies transferred the designated funds collected during the student registration period to each activity. Additionally, the yearbook coordinator received funds from parents who ordered the yearbook during the year, and the athletic director received funds from sporting events and fundraisers. Each coordinator approved and processed transactions and monitored their accounts with little or no oversight from the

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business office. To segregate duties, business office employees should approve the transactions and maintain the accounting records for those activities.

Recommendation

- *The academies should maintain a proper segregation of duties over student activity receipt and disbursement functions.*

4. The academies did not comply with the Department of Finance's and internal procedures relating to imprest cash and other local bank accounts.

The academies maintained seven local bank accounts. However, only five were authorized by the Department of Finance. The academies established the student activity and student athletic association accounts without authorization from the Department of Finance. As shown in Table 2-1, the balances in these accounts as of January 31, 2005, were \$21,949 and \$1,969, respectively. The academies did not develop any procedures for these accounts, and we were not sure why they needed to use them. As stated in Finding 1, student-related receipts are required to be deposited in the state treasury. The academies kept a separate database for a small part of the transactions, but did not record the activity on MAPS.

The academies did not comply with either the state's or its own imprest cash policies. The academies used five separate imprest cash accounts to pay for certain purchases of goods or services. The academies maintained separate student and current expense accounts for each campus. The academies used each imprest cash account for specific purposes. The two student accounts had a combined authorized limit of \$1,850. The academies used the two accounts for student allowances and field trip expenses. The two current expense accounts had a limit of \$2,675 which was funded from the academies' operations and generally used for local purchases necessary to maintain the academies on a day-by-day basis. The fifth imprest cash account had a \$5,000 limit, which was used to process student payroll. Our review of the academies' use of imprest cash accounts identified the following weaknesses:

- The academies exceeded the imprest cash authority for three of its imprest cash accounts. The Minnesota Academy for the Blind's (MSAB) current expense account exceeded its limit of \$1,675 in September and October 2001. The academies received a technology rebate of approximately \$32,600, which was wired into an imprest cash account instead of the state treasury. The Minnesota Academy for the Deaf's (MSAD) current expense account exceeded its \$1,000 limit on nine instances. A technology rebate of approximately \$31,000 was also wired in the MSAD's current expense account in 2001. The MSAD account received additional rebates of approximately \$22,300, \$7,000, and \$3,500 again in 2002, 2003, and 2005, respectively. The third account with an average was the MSAD student account, which exceeded its \$1,100 limit once in November 2002. The overages, without the rebate activity, ranged from \$40 to \$343.
- The academies' internal policy does not include specific procedures for imprest cash use, as required by the Department of Finance's policy number 0608-02. The academies'

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policy states that imprest cash is to be used to make minor disbursements and is intended to eliminate the costly processing of department purchases orders. The state's policy stresses that imprest cash transactions require the same controls as other purchases, including purchase orders or other authorization. As discussed in Finding 11 in Chapter 5, the academies used the imprest cash account to avoid purchase orders for a significant portion of its high-risk expenditures and to pay for purchases from repetitive vendors.

- The academies exceeded its \$20 limit for cashing student checks. Although the state's policy sets a limit of \$50 for standard imprest cash disbursements, the academies established its own limit of \$20 for cashing student checks. Our random sample of ten transactions showed that the academies cashed four checks in excess of the \$20.

Recommendations

- *The academies should transfer the balances from any unauthorized local bank accounts to the state treasury.*
- *The academies should operate within the established imprest cash authorization or request an increase from the Department of Finance.*
- *The academies need to revise its imprest cash policy to conform to the state's imprest cash policy.*
- *The academies should limit imprest cash payments and student check cashing services to \$20 or change its policy to reflect its practices.*

5. The academies made inappropriate transfers among its state and local accounts.

The academies transferred money or wrote checks from accounts to other local or state accounts for all seven local bank accounts. Generally, we were unable to determine the exact reason for the transfers. However, in June 2003, the academies paid nonstudent payroll expenses out of its Student Payroll Account. The academies wrote a check to an employee for \$932 to take students to a recreational event. The academies also wrote a \$500 check directly to a vendor for deaf communication services. Academy staff told us that these two events happened because the appropriate local bank account did not have enough funds.

In addition, the academies wrote checks from the unauthorized student athletic association account to the unauthorized student activity account. It was unclear to us why the academies transferred the funds to pay for athletic-related expenditures. However, we noted that 5 of the 13 disbursements made with the transferred funds exceeded the academies' local purchasing authority, as discussed in Chapter 5.

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Recommendations

- *The academies should limit transfers to authorized purposes and provide adequate documentation to support the transfers.*
- *The academies should manage local bank accounts to eliminate cash flow issues.*

6. The academies did not formalize relationships with related foundations.

The academies did not have written contracts with its foundations. Written contracts establish the rights and responsibilities of the parties. The academies have relationships with two foundations. One is for the Minnesota Academy for the Deaf (MSAD) and the other is for the Minnesota Academy for the Blind (MSAB). The foundations were created in 1996 and 1992, respectively. The mission of both foundations is to support the respective academy through fundraising, advocacy, and volunteer action.

The academies made donations totaling \$12,000 from its student activity account to the Minnesota State Academy for the Blind Foundation. We did not find board approval for these donations. The academies told us that the money was given to the Minnesota State Academy for the Blind Foundation to help purchase playground equipment for the academies. We traced the playground expenditures to the Minnesota State Academy for the Blind Foundation's income and expense report and saw the equipment on the MSAB campus.

Recommendations

- *The academies should have written contracts with related foundations to establish each party's rights and responsibilities.*
- *The academies should seek formal board approval for financial transactions with the foundations.*

Chapter 3. Grant Revenue

Chapter Conclusions

Generally, the Minnesota State Academies' internal controls provided reasonable assurance that it safeguarded its grant receipts, accurately recorded revenue in the accounting records, and complied with significant finance-related legal provisions and management's authorization. However, the academies improperly reported certain grant information to the Department of Education, as discussed in Finding 7. In addition, the academies did not properly manage its receivables, as discussed in Finding 9.

For the items tested, the academies complied with the significant finance-related legal provisions concerning grant revenue. However, the academies erroneously deposited some grant revenue, as discussed in Finding 8.

Audit Objective

The primary objective of our audit of the Minnesota State Academies' grant revenue was to answer the following questions:

- Did the academies' internal controls provide reasonable assurance that grant receipts were adequately safeguarded, accurately reported in the accounting records, and in compliance with applicable legal provisions and management's authorization?
- For the items tested, did the academies comply with material finance-related legal provisions concerning grant revenue?

Background Information

The Minnesota State Academies provide instructional services to approximately 200 students who reside in various independent school districts in Minnesota and surrounding states. The school districts pay the costs incurred by their students to attend the academies. The academies collect various types of revenue from the school districts, including general education, compensatory education, and management aide grants. The academies are allowed to keep the majority of the revenues generated, with the exception of general education revenues for the first 175 students served. The academies use state appropriations and grant revenue to fund general operations. State law establishes the method for allocating nonfederal grant revenue to the General Fund or to the academies' general operating account.

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In addition, the academies receive federal grants, mainly subgranted from the Minnesota Department of Education. The federal grants are used for special education and child nutrition purposes with the exception of a few small grants used for art and learning challenges. The federal government determines how federal grants are to be used.

For general education grants, the academies invoice the applicable independent school district for an amount calculated based on the number of students attending and a formula established in state statutes. For compensatory education revenue grants, the state Department of Education calculates the amount due from districts for special education students and notifies the academies so they can invoice each district. Management aide revenue grants are used to reimburse personnel costs for staff that provide special care or services to approximately 40 students. The Department of Education funds 68 percent of the aides' gross salaries. The academies invoice school districts for the remaining 32 percent of salaries and all costs of fringe benefits.

Table 3-1 summarizes the revenues by type for the four fiscal years ended June 30, 2004:

	<u>Total</u>	<u>Returned to General Fund</u>	<u>Retained for Operations</u>
Management Aides	\$1,138,727	N/A	\$1,138,727
General Education	1,080,055	\$823,493	256,543
Compensatory Education	503,186	N/A	503,186
Federal Education	154,424	N/A	154,424
Federal Child Nutrition	86,637	N/A	86,637
Federal Other	2,718	N/A	2,718
Total	<u>\$2,955,728</u>	<u>\$823,493</u>	<u>\$2,132,235</u>

Source: Minnesota Accounting and Procurement System.

Current Findings and Recommendations

7. The academies inaccurately reported grant information to the Department of Education resulting in an overpayment of management aide revenue.

The academies incorrectly reported the amount of gross salaries for management aides to the state Department of Education during the audit period. The academies overstated salaries by approximately \$22,000 in reports to the department. This resulted in an overpayment in aide revenue totaling about \$15,000. In addition, for compensatory grant revenue, the academies underreported one student in one of the state's Department of Education subsystems in fiscal year 2004. The academies invoiced the school district for the student it had neglected to report, but did not correct the student count in the Department of Education's subsystem.

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Recommendations

- *The academies should work with the departments of Finance and Education to repay the amounts it overcharged the state.*
- *The academies should improve internal controls over reporting its grant information to the Department of Education.*

8. The academies deposited some of its grant revenue into the wrong fund.

During fiscal years 2001 to 2003, the academies incorrectly deposited approximately \$102,000 of general educational grant revenue in the Special Revenue Fund instead of the General Fund. The academies received the revenue in lieu of out-of-state tuition from an independent school district in Iowa. The academies can accept students from other states if it does not deprive a Minnesota student of admission. However, *Minnesota Statutes* 2004, 125A.69, subd. 3, requires that, "... money received from another state must be deposited in the General Fund and credited to the general operating account of the academies. The money is appropriated to the academies." In addition, in fiscal year 2003, the academies erroneously deposited approximately \$1,500 of general education grant revenue in its Special Revenue Fund account instead of the General Fund.

Recommendations

- *The academies should request a statutory change to allow general educational grant revenues to be deposited in the Special Revenue Fund.*
- *The academies should work with the departments of Finance and Education to correct the accounting system for erroneous entries.*

9. The academies did not properly manage outstanding receivables.

The academies periodically invoiced independent school districts for their share of costs related to students who attend one of the academies' schools. The academies developed spreadsheets and established receivables in the state's accounting system (MAPS) to assist them in accurately calculating amounts due and in posting the related receipts in MAPS. As of April 2005, the academies had approximately \$151,000 of outstanding receivables from independent school districts recorded in MAPS.

Compensatory education grant receivables, at about \$133,000, accounted for the majority of the amounts outstanding. Staff told us that normally a school district must pay the academies compensatory education revenue to use for pupils who generate the revenue per *Minnesota Statute* 2004, 126C.15, subd. 2. However, in 2001, the Minnesota Department of Education issued a memo interpreting the statute and listed exceptions relieving the school districts of their

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financial obligations. The memo further directed the academies to negotiate payments with the school districts based on this interpretation. As a result, several school districts have refused to pay compensatory education revenue, because they claimed they met the “exceptions” in the 2001 Minnesota Department of Education memo. However, the academies do not agree with the “exceptions” identified in the memo.

There were other amounts outstanding for other grants. The academies had general education receivables totaling \$6,154 owed to the state’s General Fund and \$1,774 owed to the academies. The academies also were entitled to \$10,402 in management aide receivables. Staff told us that they periodically reinviced for these two types of grants, but never collected all amounts billed.

There were additional problems with how the academies tracked and reported receivables. The academies reported a \$2,512 compensatory education receivable on MAPS as a Minnesota State Academy for the Deaf compensatory education grant revenue receivable when it was a Minnesota Academy for the Blind receivable. As a result, the academies could not close the receivable when it received payment in fiscal year 2004. In addition, a management aide grant revenue receivable on the state’s accounting system was \$270 higher than what the academies invoiced and received.

Recommendations

- *The academies should seek an opinion from the Office of the Attorney General regarding the correct interpretation of Minnesota Statutes 2004, 126C.15 and work with the Department of Education to collect all valid receivables from independent school districts.*
- *The academies should identify all valid receivables, ensure that the state’s accounting system accurately reflects those receivables, and work with the departments of Finance and Education to write-off receivables that are uncollectible.*

Chapter 4. Employee Payroll Expenditures

Chapter Conclusions

The Minnesota State Academies' internal controls provided reasonable assurance that employees were accurately compensated in accordance with applicable bargaining agreements and management's authorization, and that payroll expenditures were properly recorded in the accounting and payroll systems.

For the items tested, the academies complied with the significant finance-related legal provisions and related employee bargaining agreements and compensation plans. However, the academies did not independently verify the SEMA4 payroll register to ensure that staff accurately entered payroll transactions into the state's payroll system, as discussed in Finding 10.

Audit Objective

The primary objective of our audit of the Minnesota State Academies' payroll expenditures was to answer the following questions:

- Did the academies' internal controls provide reasonable assurance that payroll expenditures were accurately recorded in the accounting records and in compliance with applicable legal provisions and management's authorization?
- For the items tested, did the academies comply with significant finance-related legal provisions including bargaining agreements and compensation plans?

Background Information

The Minnesota State Academies' main operating cost is payroll, which averaged \$10 million each year of our audit period. As of March 2005, the academies had approximately 300 employees paid bi-weekly through the State Employees Management System (SEMA4). SEMA4 interfaced payroll expenditures into the Minnesota Accounting and Procurement System (MAPS).

The academies' employees can participate in a tax-sheltered annuity program in which they elect to have a certain amount deducted from their payroll checks and invested with various vendors. The academy processes payroll deductions from employees' paychecks for the amount selected by the employee and sends the amounts to the appropriate vendors. During the audit period, employee contributions averaged about \$210,000 per year.

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Table 4-1 summarizes the payroll expenditures for the four fiscal years ended June 30, 2004.

	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
Full Time Salary and Fringe Benefits	\$7,229,443	\$ 7,756,428	\$ 8,376,227	\$ 8,067,842
Part Time Salary and Fringe Benefits	2,203,197	1,989,669	1,965,684	2,385,997
Overtime and Premium Pay	93,633	119,353	86,362	88,015
Other Payroll Expenditures	<u>300,000</u>	<u>190,380</u>	<u>195,625</u>	<u>180,161</u>
Total	<u>\$9,826,273</u>	<u>\$10,055,830</u>	<u>\$10,623,898</u>	<u>\$10,722,015</u>

Note: The payroll amounts do not include transfers made by the academies to investment companies for the employees' annuity program.

Source: Minnesota Accounting and Procurement System (MAPS) based on budgetary fiscal year basis as of June 30, 2004.

Current Finding and Recommendation

10. The academies did not independently review the payroll register to ensure that payroll transactions were entered accurately on SEMA4.

Each pay period, the academies entered payroll transactions into SEMA4, which generated payments to all employees. The same person that input the payroll transactions into SEMS4 also reviewed the payroll register output report. SEMA4 Operating Policy and Procedure PAY 0028 requires agencies to, "... review the payroll register to verify that time and amounts were paid at the correct rate, and any necessary adjustments were processed." Without this verification, erroneous payroll transactions could be entered into SEMA4 without detection.

Recommendation

- *The academies should establish an independent review of the payroll register to verify that staff entered the correct payroll transactions into SEMA4.*

Chapter 5. Administrative Expenditures

Chapter Conclusions

The Minnesota State Academies had weaknesses in controls over purchases of goods and services. In addition, the academies did not comply with some finance-related legal provisions relating to purchasing and professional/technical service contracts, as discussed in Findings 11 and 12. Finally, the academies had not performed a complete physical inventory in almost three years, as discussed in Finding 13.

The academies did not have a properly executed mainstreaming professional/technical services contract for the 2004-2005 school year until June 2005.

Audit Objective

The primary objective of our audit of administrative expenditures was to answer the following questions:

- Did the academies' internal controls provide reasonable assurance that purchases were properly authorized, adequately safeguarded, and accurately reported in the state's accounting system and in compliance with significant finance-related legal provisions and management's authorization?
- For the items tested, did the academies properly record fixed assets in the state's fixed asset inventory system, and were the records accurate and complete?
- Did the academies follow applicable guidelines related to professional/technical contract agreements?

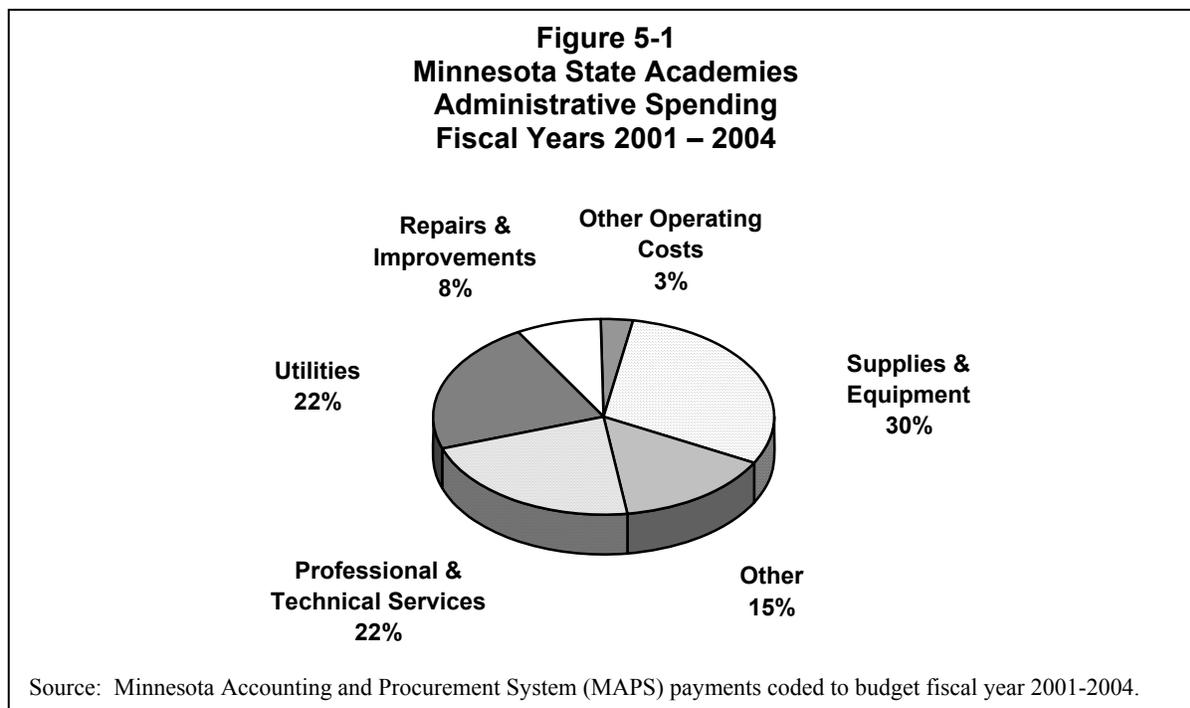
Background Information

The authority to purchase goods and services for state agencies originates with the Commissioner of Administration. The department can delegate purchasing authority to individual employees of state agencies. The state trains and certifies employees designated by an agency. The authority delegated to an employee belongs only to that employee and cannot be transferred or assigned. A designated and certified employee of the academies is required to oversee all purchases under \$2,500. Purchases in excess of \$2,500 up to \$5,000 require additional training and certification. The academies have two individuals certified up to the \$5,000 level. In addition, there is a certification for purchases from \$5,000 up to \$25,000 and a special delegation granting authority in excess of \$25,000. The academies do not have these

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higher authority levels and must work through the Department of Administration when making larger purchases.

Figure 5-1 shows the level of administrative expenditures by category.



Supplies and Equipment

The Minnesota State Academies spent \$1,832,000 on supplies and \$573,000 on equipment purchases during the four-year audit period. The academies used the state's procurement system for its purchases, including the use of state contracts and local purchasing authority. The academies also made purchases using imprest cash accounts and local vendor charge accounts.

Professional and Technical Services

In fiscal years 2001 through 2004, the academies expended \$1,787,000 for professional and technical services. The majority of the expenditures were for an annual mainstreaming contract with the Faribault public school district. Students from the academies attended public schools in the local district and interacted with children who were not disabled. These annual contracts paid for the cost of the academies' students attending the local schools. The academies and the Faribault school district operated without a signed mainstreaming contract for the 2004/2005 school year. The state departments of Finance and Education were working with the academies and the Faribault public schools to make changes in the funding of the mandated mainstreaming.

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Utilities and Building Maintenance

The academies' utility and building maintenance expenditures of \$1,789,000 during the audit period consisted primarily of utility billings, including payments made to the state Department of Corrections for steam heat.

Other Administrative Expenditures

The academies made repairs and improvements during fiscal years 2001 through 2004 of \$615,000. They also spent approximately \$210,000 for other operating costs, primarily for waste management services and student busing. The academies other costs during fiscal years 2001 through 2004 were \$1,231,000. The majority of these expenditures were for travel, communication, and indirect costs.

Current Findings and Recommendations

11. The academies did not follow the state's purchasing guidelines when buying items to operate its facilities.

The academies did not always use purchase orders when buying goods and did not document management's authorization for the purchases, as follows:

- The academies did not use the state's required purchase orders when making routine purchases. Rather, it used a steno book to record and monitor purchases. The academies referred to these "steno book orders" as field purchase orders. However, the academies did not follow the state's restrictions on field purchases. The state says field purchases are appropriate when an employee is not in their primary work location and has an immediate need situation. Field purchases also require a field purchase order. The academies did not use field purchase orders. Instead, a sequential numbering system in a steno book was used to track the purchases. During our audit period, the academies used this practice for 369 purchases ranging from \$7 to \$2,470.

We analyzed all supply and equipment purchases in MAPS for our audit period and found that 11 percent, or \$261,000, of the academies' purchases did not have purchase order numbers. The five largest vendors identified in the steno book were paid a total of \$29,300. Of that amount, only \$10,300 of payments had purchase order numbers recorded in MAPS.

- The academies did not document management's authorization for some purchases. The "steno book orders" did not contain any signatures authorizing the purchase. The person in charge of the steno book did not have local purchase authority delegated by the Department of Administration. The person making the purchase simply ordered the goods needed. Because of the lack of authorized signatures, we could not determine if the goods purchased were for appropriate purposes.

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- The academies did not segregate the purchasing and payment functions. The academies allowed the accounts payable accountant to create, track, and process payments for the “steno book orders,” which is poor segregation of duties. Further, the employee did not use the three-way match (purchase orders/receiving documentation/invoices) on the state’s accounting system (MAPS) to verify the accuracy of the transaction amounts as required by the Department of Finance’s policy number 0803-01.

Recommendations

- *The academies should follow state procurement and disbursement regulations by using department purchase orders, encumbering funds, and obtaining authorizations prior to purchasing goods or services. The academies should ensure that its staff is aware of these regulations.*
- *The academies should maintain a proper segregation of duties for purchases and payments.*

12. The academies used a vendor-issued charge card and agreed to the terms and conditions with another large vendor for some purchases.

The academies used a nonstate issued purchasing card to buy approximately \$39,000 of supplies and equipment, ranging from camera film to televisions from one vendor. In addition, the academies agreed to terms and conditions for purchases made on account from another large vendor. Staff of the Department of Administration told us that agencies must get prior written approval before entering into purchasing card and other agreements that have terms and conditions. The academies effectively signed contracts they had no authority to sign when they entered into purchasing agreements with the two vendors. The academies told us that other vendor relationships that involve special terms and conditions may exist.

Recommendation

- *The academies should not use vendor-issued charge cards or agree to terms or conditions for purchases until it receives proper authorization.*

13. The academies have not performed a complete physical inventory in three years.

The academies’ last complete physical inventory was in June 2002. However, the academies performed annual physical inventories for computer equipment and vehicles. The state Department of Administration informational bulletin 03.19 policy on property management requires a complete physical inventory count for capital assets biennially, at a minimum. In addition, the academies had not affixed a fixed asset label to one of three fixed asset sample items tested. The state’s policy on property management also states that agencies should affix a numbered asset label on fixed assets as soon as the goods are received and found acceptable.

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Recommendations

- *The academies should conduct a physical inventory of capital assets biennially.*
- *The academies should ensure that every fixed asset has a number asset label.*

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Status of Prior Audit Issues As of April 8, 2005

Legislative Audit Report 01-39, issued in August 2001, covered the four fiscal years ending June 30, 2000. The audit scope included tuition revenue, resident accounts, payroll, and other administrative expenditures. The report contained four audit findings. The most significant finding involved the allocation of basic education revenue to the state's General Fund. We recommended that MSA either follow statutory language to calculate the amounts allocated or consider seeking a revision of the state statute. The academies sought and were awarded a retroactive revision of *Minnesota Statutes* 2004, 125A.65, subd. 8. The last audit also reported three other findings, two of which we found were adequately resolved. The fourth finding was partially resolved and is repeated as part of Finding 2 in Chapter 2.

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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Minnesota State Academies

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400 SE 6th Avenue
Faribault MN 55021-6356
507-333-4800

Minnesota State Academy for the Deaf
615 Olof Hanson Drive, PO Box 308
Faribault MN 55021-0308
507-332-5400

December 14, 2005

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

Dear Mr. Nobles:

Enclosed are our responses regarding the recent audit conducted at the Minnesota State Academies. The audit report, the findings, and the recommendations were discussed with the agency administrators in an exit conference on December 8, 2005.

The Minnesota State Academies has already implemented six of the recommendations to the findings and is in the process of implementing the others. If there is any part of our response to the findings that is unclear, please feel free to contact me.

We want to thank those on the legislative audit team for the manner in which they conducted the audit. Staff found them to be respectful and professional during the audit process. We value the time that the team spent with us and appreciate working with them.

Sincerely,

/s/ Linda Mitchell

Linda Mitchell
Minnesota State Academies

enclosure

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Finding # 1: The academies did not establish appropriate controls to safeguard student athletic funds.

Response to # 1:

The recommendation to this finding is already implemented. Tom Schoenbauer is responsible for establishing and maintaining an internal control structure to ensure that no one individual has complete control of student athletic activity financial transactions. Patty Rux will process all purchase requests to be made from the student athletic activity account using the Minnesota Accounting and Procurement System (MAPS). The activity advisor is responsible for maintaining documentation for its athletic activities and fundraising events, such as ticket sales and concessions, and reconciling the supporting documentation to monies collected. Alyce Vranek will deposit all student related fundraising monies in the state treasury and record all student related activity on MAPS. Rick Caron is responsible for monitoring the activity financial transactions.

Finding # 2: The academies did not retain documentation to support deposits and withdrawals from student's accounts.

Response to # 2:

The recommendation to this finding is already implemented. Patty Rux is responsible for the collection of all signed student allowance sheets. Tom Schoenbauer will train staff that will be receipting money during the enrollment at the beginning of each school year to ensure receipt copies are not altered at this time.

Finding # 3: The academies did not adequately segregate duties for certain student activities.

Response to # 3:

This recommendation to this finding is already implemented. Tom Schoenbauer is responsible for maintaining a proper segregation of duties over student activity receipts and disbursements at the Academies.

Finding # 4: The academies did not comply with the Department of Finance's and internal procedures relating to imprest and other local bank accounts.

Response to # 4:

The recommendation to this finding is partially implemented. The balances from the two unauthorized local bank accounts have been deposited in MAPS to the state treasury. Marcey Johnson and Patty

Rux will maintain the balances in their respective checking accounts so as not to exceed the imprest cash authority. Tom Schoenbauer will revise the academies imprest cash policy to conform to the state's imprest cash policy within 90 days but for now the academies will continue to limit cash payments and student check cashing service to \$20.

Finding # 5: The academies made inappropriate transfers among its state and local accounts.

Response to # 5:

The recommendation to this finding is already implemented. With the closing out of the two checking accounts, the need for transfers has been eliminated. Tom Schoenbauer has received approval from the department of finance to decrease the amount authorized for student payroll and increase the amount authorized for current expense which should eliminate the cash flow issue.

Finding # 6: The academies did not formalize relationships with related foundations.

Response to # 6: **The recommendation to this finding is being implemented. Linda Mitchell has contacted an attorney to assist the Minnesota State Academies in setting up a formalized contract relationship with the Minnesota State Academy for the Blind Foundation and the Minnesota State Academy for the Deaf Foundation. The goal is to have these finalized within the next six months.**

Finding # 7: The academies inaccurately reported grant information to the Department of Education resulting in an overpayment of management aide revenue.

Response to # 7:

Tom Schoenbauer and Rick Caron will work with the departments of Finance and Education to repay the \$14,865.25 which is an overpayment in aide for the audit period. The overage will be repaid by the end of the fiscal year. Rick Caron will monitor the reporting to the Department of Education to assure accuracy of data submitted.

Finding # 8: The academies deposited some of its grant revenue into the wrong fund.

Response to # 8:

MSA will pursue statutory changes to allow out-of-state tuition revenue to be deposited in the Special Revenue Fund. Until such time statutory changes are finalized, MSA will follow current law. Tom Schoenbauer and Rick Caron will work with the department of Finance to correct the erroneous deposit of \$1,528.44 in the Special Revenue Fund instead of the General Fund

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Finding # 9: The academies did not properly manage outstanding receivables.

Response to # 9:

MSA will seek an opinion from the Office of the Attorney General regarding the correct interpretation of Minnesota Statutes 2004, 126C.15 and work with the Department of Education to collect all valid receivables from independent school districts. Tom Schoenbauer and Rick Caron will identify all valid receivables, and work with the departments of Finance and Education to write-off receivables that are uncollectible. The intent is to have this completed by the end of the fiscal year.

Finding # 10: The academies did not independently review the payroll register to ensure that payroll transactions were entered accurately on SEMA 4.

Response to # 10:

The recommendation to this finding will be implemented by 12-19-2005 by Tom Schoenbauer.

Finding # 11: The academies did not follow the state's purchasing guidelines when buying items to operate its facilities.

Response to # 11:

The recommendation to this finding is already implemented. All purchase requests have written authorization before Patty Rux processes a department purchase order. Rick Caron is responsible for the payment function using the three-way match on MAPS.

Finding # 12: The academies used a vendor-issued charge card and agreed to the terms and conditions with another large vendor for some purchases.

Response to #12:

Tom Schoenbauer along with Linda Mitchell has submitted a request to the Department of Administration to issue two State Purchasing Cards for the academies. The goal is to have this operational in 30 days.

Finding # 13: The academies have not performed a complete physical inventory in three years.

Response to # 13:

Patty Rux will conduct a complete physical inventory of capital assets within the next 30 days. Ms. Rux will ensure that every fixed asset has a number asset label.