



OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

FINANCIAL AUDIT DIVISION REPORT

General Obligation Bond Expenditures

Internal Controls and Compliance Audit

March 6, 2014

Report 14-06

FINANCIAL AUDIT DIVISION
Centennial Building – Suite 140
658 Cedar Street – Saint Paul, MN 55155
Telephone: 651-296-4708 • Fax: 651-296-4712
E-mail: legislative.auditor@state.mn.us
Web site: <http://www.auditor.leg.state.mn.us>
Through Minnesota Relay: 1-800-627-3529 or 7-1-1



OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

March 6, 2014

Senator Roger Reinert, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. James Schowalter, Commissioner
Department of Management and Budget

This report presents the results of our internal controls and compliance audit of the General Obligation Bond Expenditures authorized by *Laws of Minnesota* 2008, chapter 179, and *Laws of Minnesota* 2010, chapter 189, and expended through February 28, 2013.

We discussed the results of the audit with the Department of Management and Budget staff on February 6, 2014. This audit was conducted by Jim Riebe, CPA, (Audit Manager) and Laura Wilson, CPA, CISA (Auditor-in-Charge), assisted by Kayla Borneman, CPA, CFE, Carmen Marg-Patton, CPA, Joe McMahon, CPA, Kelsey Nistler, CPA, and Kathy Rootham. For projects administered by the University of Minnesota, we relied on audit procedures performed by the university's Office of Internal Audit.

We received the full cooperation of the Department of Management and Budget and other entities included in our scope while performing this audit, and we thank the university's Office of Internal Audit for their assistance.

Handwritten signature of James R. Nobles in black ink.

James R. Nobles
Legislative Auditor

Handwritten signature of Cecile M. Ferkul in black ink.

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

Table of Contents

	<u>Page</u>
Report Summary	1
Background	3
Objective, Scope, and Methodology	3
Conclusion	7
Findings and Recommendations	9
1. Entities used bond proceeds to pay for some ineligible costs	9
2. The Department of Management and Budget did not provide adequate guidance to help entities determine whether bond proceeds could be used for computer and software costs.....	14
3. The Department of Management and Budget allowed some entities to use bond proceeds appropriated for capital projects without determining the sufficiency of money from other sources needed for the projects.....	17
4. The Department of Management and Budget did not verify that state agencies and grantees filed real estate declarations with the county on property purchased or bettered with bond proceeds.....	20
5. Several entities had internal control weaknesses resulting in noncompliance with accounting and procurement policies and procedures.....	22
6. Several entities did not always submit information to the Department of Administration, certain members of the Legislature, or the Department of Management and Budget, as required by state statute or state policy.....	25
7. Several entities incurred costs before the effective date of the bonding bills without notifying the Department of Management and Budget	27
Appendix A. Capital Projects Selected for Audit Testing	31
Agency Responses	33
Management and Budget	33
Employment and Economic Development	39
Metropolitan Council.....	41
Military Affairs.....	45
Minnesota Amateur Sports Commission.....	47
Minnesota State Colleges and Universities	49
Minnesota Zoo	51
Natural Resources.....	53
Public Facilities Authority.....	55
Transportation.....	57
University of Minnesota	59
Water and Soil Resources Board.....	61

Report Summary

Conclusion

The entities we audited generally had adequate internal controls to ensure that they used general obligation bond proceeds in compliance with applicable finance-related legal requirements. However, we found several weaknesses in internal controls.

The capital projects and grants we tested generally complied with applicable finance-related legal requirements. However, we found some costs that did not comply with specific legal requirements.

The Department of Management and Budget did not fully implement two recommendations from our 2012 follow-up review of the 2008 audit report.¹ Findings 3 and 4 include recommendations that had not been fully implemented.

Key Findings

- Entities used bond proceeds to pay for some ineligible costs. ([Finding 1, page 9](#))
- The Department of Management and Budget did not provide adequate guidance to help entities determine whether bond proceeds could be used for computer and software costs. ([Finding 2, page 14](#))
- The Department of Management and Budget allowed some entities to use bond proceeds appropriated for capital projects without determining the sufficiency of money from other sources needed for the projects. ([Finding 3, page 17](#))
- The Department of Management and Budget did not verify that state agencies and grantees filed real estate declarations with the county on property purchased or bettered with bond proceeds. ([Finding 4, page 20](#))
- Several entities had internal control weaknesses resulting in noncompliance with accounting and procurement policies and procedures. ([Finding 5, page 22](#))

¹ Office of the Legislative Auditor's Financial Audit Division Report 08-34, *General Obligation Bond Expenditures, Internal Control and Compliance Audit*, issued December 5, 2008, and Report 12-14, *General Obligation Bond Expenditures, Follow-up Review of 2008 Audit Recommendations*, issued July 26, 2012.

Audit Objectives and Scope

We focused our audit on expenditures (through February 28, 2013) related to projects authorized by the 2008 and 2010 bonding bills. The bonding bills appropriated about \$1.6 billion of general obligation bond proceeds, and we audited 28 projects at 12 entities, totaling about \$558 million of expenditures.² Our objectives were to ensure the entities spending bond proceeds had adequate internal controls and complied with the various finance-related legal requirements, including the state constitution, statutes and laws, the Department of Management and Budget's general obligation bond expenditures policies, and other state policies.

² In addition to our review in this audit, we conducted a special review that included about \$8.8 million of bond proceeds the Department of Employment and Economic Development granted to the Minnesota Orchestral Association for the renovation of Orchestra Hall. We concluded that the payment process for the costs related to the Orchestra Hall renovation project included adequate internal controls to ensure that money appropriated from the bond proceeds fund was used in accordance with applicable finance-related legal requirements. We did not identify any payments for costs that did not comply with applicable legal requirements. See Office of the Legislative Auditor's Financial Audit Division Report 13-10, *State Money Provided to the Minnesota Orchestral Association, Special Review*, issued June 13, 2013.

Background

The *Minnesota Constitution* authorizes the state to incur public debt for limited, specified purposes.³ The specified purposes include “public improvements of a capital nature,” such as the construction of new buildings, bridges, and roads; the purchase and betterment of publicly owned land; and asset preservation to maintain the buildings and land the state and its political subdivisions already own.⁴ Under this authority, the Minnesota Legislature enacts laws (often called “bonding bills”) that authorize specific projects to be funded with the proceeds from the sale of general obligation bonds. The Department of Management and Budget periodically issues bonds to pay for the projects. As of June 30, 2012, the state had approximately \$6 billion of general obligation bonds outstanding.

In December 2008, our office issued an internal controls and compliance audit report on the state’s use of proceeds from general obligation bond sales.⁵ The audit focused on projects authorized by the 2006 bonding bill and reviewed a sample of expenditures at 12 entities.⁶ The report contained six findings. In July 2012, we conducted a follow-up audit on the 2008 report and assessed the state’s progress toward resolving the findings and implementing the recommendations.⁷ Because the use of bond proceeds is an important aspect of the state’s financial operations, and the state had not fully implemented several of the 2008 recommendations, we decided to conduct another audit of the state’s internal controls and compliance with finance-related legal provisions for general obligation bond expenditures, which is the focus of this report.

Objective, Scope, and Methodology

Our audit of the state’s use of the proceeds from the sale of general obligation bonds focused on expenditures through February 28, 2013, related to the projects authorized by the *Laws of Minnesota* 2008, chapter 179 and *Laws of Minnesota* 2010, chapter 189 (the 2008 and 2010 bonding bills). Combined, these two laws

³ *Minnesota Constitution* Article XI, section 5.

⁴ The constitutional provision authorized debt to be used for a wide range of other purposes, including “to promote forestation and prevent and abate forest fires...; to construct, improve and operate airports and other air navigation facilities; to develop the state’s agricultural resources by extending credit on real estate security...; to improve and rehabilitate railroad rights-of-way and other rail facilities whether public or private.” However, these other uses were not part of our audit.

⁵ Office of the Legislative Auditor’s Financial Audit Division Report 08-34, *General Obligation Bond Expenditures, Internal Control and Compliance Audit*, issued December 5, 2008.

⁶ *Laws of Minnesota* 2006, Chapter 258.

⁷ Office of the Legislative Auditor’s Financial Audit Division Report 12-14, *General Obligation Bond Expenditures, Follow-up Review of 2008 Audit Recommendations*, issued July 26, 2012.

appropriated about \$1.6 billion in bond proceeds. As of February 28, 2013, the state and other entities had expended about \$1.3 billion of those appropriations.

The objective of the audit was to answer the following questions:

- Did the entities have adequate internal controls to safeguard resources, comply with applicable finance-related legal provisions, and produce reliable financial data?
- For the projects and transactions tested, did the entities spend bond proceeds in compliance with the constitution, state statutes and laws, state policies, and other applicable finance-related legal provisions?
- Did the entities resolve the prior audit findings?⁸

To answer these questions, we gained an understanding of the various finance-related legal provisions, including the state constitution, statutes and laws, Department of Management and Budget's general obligation bond expenditure policies, and other state policies. We considered the risk of noncompliance with these finance-related legal requirements and the risk of ineligible expenditures occurring without detection.

In determining our scope, we considered the dollar amount of appropriations authorized in the bonding bills and the scope and findings from our prior audit of general obligation bond expenditures. We analyzed accounting data to identify appropriations that may have incurred ineligible costs. We included some projects that had been completed (or were nearly completed) to address the risk of unspent appropriations not being returned to the bond fund. We also included some entities in our scope that we had not included in the scope of our 2008 audit.

Based on our analysis, we selected for testing 28 projects totaling about \$558 million of expenditures at 12 entities. Table 1 identifies the entities included in our scope, the total appropriations and number of projects authorized in the two bonding bills, and the total number of projects and expenditures we tested on a sample basis. Appendix A provides a list by entity of the specific projects tested.

⁸ Office of the Legislative Auditor's Financial Audit Division Report 12-14, *General Obligation Bond Expenditures, Follow-up Review of 2008 Audit Recommendations*, issued July 26, 2012.

Table 1
General Obligation Bond Appropriations and
Expenditures for Entities in Audit Scope
2008 and 2010 Bonding Bills (Combined)
(in thousands)

Entity	Total Appropriations¹	Total Expenditures	Total Projects	Projects Tested	Total Expenditures for Projects Tested
Amateur Sports Commission	\$ 4,950	\$ 4,938	2	1	\$ 3,988
Administration ²	187,929	146,767	42	2	55,334
Employment and Economic Development	181,850	136,786	17	2 ³	43,434 ³
Metropolitan Council	65,717	44,691	12	3	33,407
Military Affairs ²	28,900	24,084	8	1	4,820
Minnesota Zoo	23,500	23,201	3	3	23,201
Minnesota State Colleges and Universities	347,094	342,491	42	6	125,079
Natural Resources	197,886	168,174	48	3	67,803
Public Facilities Authority	105,950	104,856	7	1	23,976
Transportation	122,727	88,235	11	2	55,004
University of Minnesota	194,833	175,315	10	3	106,762
Board of Water and Soil Resources	<u>32,975</u>	<u>23,939</u>	<u>4</u>	<u>1</u>	<u>14,854</u>
Total	<u>\$1,494,311⁴</u>	<u>\$1,283,477</u>	<u>206</u>	<u>28</u>	<u>\$557,662</u>

¹ We did not adjust the amounts appropriated in the 2008 and 2010 bonding bills for amounts cancelled in subsequent legislative session laws.

² The Department of Administration managed several projects where the bonding bill named other state entities in the appropriation law. In addition, the department transferred \$11 million and project management responsibility for two projects related to Camp Ripley to the Department of Military Affairs.

³ In addition to the two Employment and Economic Development projects we tested in this audit (totaling \$43,434,000), we tested another project totaling \$8,782,000 as part of a Special Review. See Office of the Legislative Auditor's Financial Audit Division Report 13-10, *State Money Provided to the Minnesota Orchestral Association, Special Review*, issued June 13, 2013.

⁴ The 2008 and 2010 bonding bill appropriations totaled \$1,563,795,000. Twelve entities not included in our audit scope received \$69,484,000 in appropriations.

Source: *Laws of Minnesota* 2008, Chapter 179; *Laws of Minnesota* 2010, Chapter 189; and the state's accounting system.

We interviewed staff at the various entities to gain an understanding of their internal controls over expenditures paid from bond proceeds. We selected a sample of specific expenditure transactions charged to those projects and reviewed supporting documentation, including grant agreements, contracts, purchase orders, and invoices to test whether the entities' internal controls were effective and if the transactions complied with laws, regulations, policies, and grant and contract provisions.

For general obligation bond proceeds expended by the University of Minnesota, we relied on work done by the university's Office of Internal Audit. We selected the projects for the audit and oversaw the design and completion of the audit procedures. We reviewed the Office of Internal Audit's findings and supporting documentation and incorporated their findings into this report.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives.

We used various criteria to evaluate internal controls and compliance. We used the guidance contained in the *Internal Control-Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission as our criteria to evaluate entity controls.⁹ We used various legal resources to assess whether project costs were allowable, including the following:

- The *Minnesota Constitution* restricts the purposes for which the state can sell general obligation bonds. For example, it requires that bond proceeds be used for costs that are of a "capital nature."
- **State statutes** provide additional requirements governing the use of bond proceeds.
- **Appropriation laws** identify specific projects for which bond proceeds can be used.
- **Bond counsel opinions** interpret various constitutional and statutory requirements.¹⁰
- The Department of Management and Budget's **bond expenditure policies and procedures**, including the Capital Grants Manual, commissioner's orders, and *After the Bonding Bill—The Next Steps* memos provided further guidance in various areas, including oversight of bond fund grants to political subdivisions, documentation requirements when charging personnel costs to bond funds, and verification requirements for a project's matching funds.

⁹ The Treadway Commission and its Committee of Sponsoring Organizations were established in 1985 by the major national associations of accountants. One of their primary tasks was to identify the components of internal control that organizations should have in place to prevent inappropriate financial activity. The resulting *Internal Control-Integrated Framework* is the accepted accounting and auditing standard for internal control design and assessment.

¹⁰ Bond counsel opinions are available on the Web site of the Department of Management and Budget at: <http://www.beta.mmb.state.mn.us/bond-opinion>.

Conclusion

The entities we audited generally had adequate internal controls to ensure that they used general obligation bond proceeds in compliance with applicable finance-related legal requirements. However, we found several weaknesses in internal controls.

The capital projects and grants we tested generally complied with applicable finance-related legal requirements. However, we found some costs that did not comply with specific legal requirements.

The Department of Management and Budget did not fully implement two recommendations from our 2012 follow-up review of the 2008 audit report. Findings 3 and 4 include recommendations that had not been fully implemented.

The following Findings and Recommendations section provides further explanation about the exceptions noted above.

Findings and Recommendations

Entities used bond proceeds to pay for some ineligible costs.

Finding 1

Among the costs we tested, we found that entities used \$747,328 of bond proceeds for costs that were not eligible uses of bond funds, including moving and relocation costs, operating costs, and other ineligible costs.

For the 12 entities we selected for testing, we chose 28 specific capital projects totaling approximately \$558 million in expenditures as of February 28, 2013, as shown in Appendix A. From these projects, we selected a sample of 520 project expenditures for testing. The amount of the transactions included in this sample totaled about \$121 million, or approximately 22 percent of the selected projects' expenditures.

To create the sample, we selected higher dollar transactions and those that tended to have a higher risk of noncompliance with eligible uses of bond proceeds based on how the transactions were categorized in the accounting system. When our examination of the supporting documentation suggested that ineligible costs may have been paid, we expanded our testing to include other similar project costs or other payments to the same vendor. We also identified some ineligible costs through analytical testing of the entities' financial transactions.

Entities had the following ineligible costs:

Moving and Relocation Costs

Several entities used bond proceeds for ineligible moving and relocation costs, totaling \$359,139 in the transactions we tested. These costs included leases for temporary classrooms, work space, and storage units, and costs to move existing equipment from the building being renovated to the storage units or temporary classrooms.

A 1990 bond counsel opinion concluded that moving expenses do not qualify as capital expenditures.¹¹ (The opinion did not directly address relocation costs.) Based on that opinion, we raised concerns in our 2008 report and the 2012 follow-up report about entities using bond proceeds to pay for moving and relocation costs and recommended that the Department of Management and Budget clarify the eligibility of these types of costs. In its 2012 *After the Bonding Bill* memo, issued in June 2012, the department stated that (effective immediately, including for past bonding appropriations) it had adopted a policy that bond proceeds could

¹¹ Thomas Hay, Dorsey & Whitney (bond counsel) letter to Peter Sausen, Minnesota Department of Finance, March 15, 1990, paragraph 3(a). This opinion is titled, *Expenditures Eligible for State General Obligation Bond Financing*, on the Department of Management and Budget's Web site at: <http://www.beta.mmb.state.mn.us/bond-opinion>, and is labeled Exhibit C.

not be used for moving and relocation expenses. The department further stated that if a legislative appropriation specifically authorized use of bond proceeds for moving and relocation expenses, the entity must consult with the department for its determination of whether the costs are bond-eligible expenses.

We found the following ineligible costs in the transactions we tested:

- The Department of Military Affairs used \$23,511 for ineligible moving and relocation costs. Specifically, for a project at Camp Ripley, the department paid \$16,411 for delivery, removal, and rental fees for storage containers and semi-trailer containers, and \$7,100 for temporary office space for employees.
- The Minnesota State Colleges and Universities' Saint Paul College used \$292,127 to temporarily relocate several of its programs' shops (auto body, machine, and carpentry) that were undergoing renovation. Three other colleges used \$43,501 in bond proceeds to pay for ineligible moving and relocation expenses as follows: Minneapolis Community and Technical College (\$11,793); Minnesota State University, Mankato (\$23,950); North Hennepin Community College (\$7,758).

It may seem reasonable to pay moving and relocation costs when they are a necessary part of a capital project. However, as noted above, the Department of Management and Budget has determined, based in part on advice from the state's bond counsel, that these costs are not appropriate uses of bond proceeds.

Operating Costs

Several entities paid a total of \$19,164 from bond proceeds for ineligible operating costs in the transactions we tested. We again based this judgment on a bond counsel opinion and guidance issued by the Department of Management and Budget.

In an attachment to a 1989 bond counsel opinion, the department acknowledged that there is a certain amount of subjectivity in determining whether a cost is an operating or capital cost. The department offered the following guidance:

The basic test will be the extent to which a proposed expenditure relating to physical facilities is linked to a new program, changes the scope of existing programs, or significantly extends the life or increases the value of existing facilities. Further tests will be whether the proposed expenditure is of a recurring nature or not and the dollar amount of the request.¹²

¹² Attachment to Thomas Hay, Dorsey & Whitney (bond counsel) letter to Peter Sausen, Minnesota Department of Finance, April 24, 1989. This opinion is titled, *Expenditures Eligible for State General Obligation Bond Financing*, on the Department of Management and Budget's Web site at: <http://www.beta.mmb.state.mn.us/bond-opinion>.

The department also stated that capital costs are distinguished from operating costs by the following characteristics:

- They involve program improvements or program expansion.
- They extend the life of or enhance the value of a facility.
- They are nonrecurring in nature.
- They normally are financed through bond sales.
- They are project specific.

In the attachment, the department pointed out that some projects, such as a roof project, may be a capital cost or operating cost, depending on whether the project involves the major replacement of the roof or minor repairs. Major projects would extend the useful life of the asset and, therefore, be considered capital projects.

In 1990 the bond counsel issued another opinion that added details on the types of purchases that do not qualify for bond funding. For example, the opinion said that purchase or repair of minor moveable equipment or other equipment having an actual useful life of less than ten (10) years are not eligible capital expenditures.¹³ In addition, the Department of Management and Budget's 2010 *After the Bonding Bill* memo identified "general operating expenses, overhead, master planning, maintenance, and operating costs" as ineligible operating costs.

Among the costs we tested, we found that the following entities paid ineligible operating costs from bond proceeds:

- The Department of Employment and Economic Development reimbursed the Duluth Entertainment and Convention Center Authority \$5,045 for cleaning tools and supplies (including vacuums, mops, and brooms) and \$609 for flashlights, hand tools, and batteries. The reimbursement was paid from the \$38 million Duluth Entertainment and Convention Center appropriation for improvements and renovations to the center.¹⁴
- Minnesota State University, Mankato paid \$941 for cleaning supplies from the Trafton Science Center renovation appropriation.¹⁵

¹³ Thomas Hay, Dorsey & Whitney (bond counsel) letter to Peter Sausen, Minnesota Department of Finance, March 15, 1990, paragraph 3(a). On the Department of Management and Budget's Web site, this opinion is labeled Exhibit C.

¹⁴ *Laws of Minnesota* 2008, Chapter 179, section 21, subd. 7.

¹⁵ *Laws of Minnesota* 2008, Chapter 179, section 3, subd. 14

- The Amateur Sports Commission, the Department of Employment and Economic Development, the Department of Military Affairs, and the Minnesota Zoo used bond proceeds (\$4,259, \$3,620, \$4,060, and \$630, respectively, in the transactions we tested) for software subscription fees and warranties and computer maintenance and service agreements.

Costs Ineligible for Higher Education Asset Preservation Funding

Minnesota State Colleges and Universities used bond proceeds from asset preservation appropriations for ineligible costs, totaling \$256,248 in the transactions we tested.

Minnesota Statutes 2013, 135A.046, subd. 2, establishes criteria for the types of projects that may be funded with a Higher Education Asset Preservation and Replacement appropriation. Projects must preserve and replace existing campus facilities and involve one or more of the following:

- code compliance, Americans with Disabilities Act requirements, hazardous material abatement, access improvement, or air quality improvement;
- building energy efficiency improvements using current best practices;
- building or infrastructure repairs necessary to preserve the interior and exterior of existing buildings; or
- renewal to support the existing programmatic mission of the campuses.

Among the transactions we tested, the Minnesota State Colleges and Universities used money appropriated for asset preservation projects for furniture, audio-video equipment, and computer equipment that did not preserve or replace existing campus facilities, as required by state statute.¹⁶ Specifically, the Minneapolis Community and Technical College used \$162,777 for furniture and audio-video equipment, and Minnesota State University, Moorhead, used \$93,471 to purchase furniture, audio-video equipment, and computer equipment.

Other Ineligible Costs

Entities used bond proceeds for the following other types of ineligible costs, totaling \$112,777, in the transactions we tested:

- The Amateur Sports Commission reimbursed the city of Rochester \$15,935 for employee training from a \$4 million grant for the second phase of the city's National Volleyball Center expansion. The costs paid

¹⁶ *Minnesota Statutes* 2013, 135A.046, subd. 1.

for an employee's out-of-state travel costs and registration fees for training about the Best Value Procurement/Performance Information Procurement System.¹⁷ The city believed this training was eligible for reimbursement from bond proceeds because it thought staff needed this training to adequately manage the project; however, as explained below, training is not considered a capital cost.

Generally accepted government accounting principles include as capital costs "ancillary charges necessary to place the asset into its intended location and condition for use."¹⁸ In its interpretation of the definition of "ancillary charges," the Government Finance Officers Association specifically excludes training costs because they are not directly attributable to preparing the *asset* for use, and because "there often is little or no reason to believe that the tenure of an employee who is being trained . . . will match the useful life of the capital asset."¹⁹

- The Minnesota State Colleges and Universities inadvertently paid \$12,586 from the \$13.5 million appropriation for Saint Paul College's Transportation and Applied Technology Laboratories and Shops project for costs that were not directly attributable to the project. The documentation we examined supporting the costs identified that they were part of a different project to remodel faculty offices.
- The Minnesota State Colleges and Universities exceeded the statutory artwork allowance by \$59,486 on an \$8.9 million project to expand and renovate the Sattgast Science Building at Bemidji State University. *Minnesota Statutes* 2013, 16B.35, subd. 1, establishes the artwork allowance and states, in part, the following:

An appropriation for the construction or alteration of any state building may contain an amount not to exceed one percent of the total appropriation for the building for the acquisition of works of art, excluding landscaping, which may be an integral part of the building or its grounds, attached to the building or grounds or capable of being displayed in other state buildings.

The university used the art allowance to install a fountain in the plaza adjoining the building. It contracted with an artist to create a large stainless-steel fountain sculpture, but did not realize that the artist's contract did not include the construction of the concrete fountain into

¹⁷ The Best Value Procurement/Performance Information Procurement System (developed by staff at Arizona State University) is a process where both price and performance (instead of just price) are considered in awarding contracts.

¹⁸ Governmental Accounting Standards Board Statement 34, paragraph 18, as amended by Statement 37, paragraph 6.

¹⁹ *Governmental Accounting, Auditing and Financial Reporting* (2012), published by the Government Finance Officers Association, page 445.

which the sculpture needed to be installed. With the additional cost of the concrete fountain, the cost totaled \$148,486, exceeding the 1 percent allowance by \$59,486.

- The Department of Transportation paid the city of Rochester \$24,770 from bond proceeds to pay a 30-year-old water connection fee and 10 years of related accrued interest. The costs were ineligible because they had no relationship to the construction of the new Rochester Maintenance Facility authorized in the 2010 bonding bill.

Recommendations

- *The entities cited in this finding should repay the bond proceeds fund for costs that did not comply with legal provisions for the use of bond proceeds.*
- *The entities and the Department of Management and Budget should assess the need to identify and repay the bond proceeds fund for similar types of ineligible costs not directly identified by our testing.*

Finding 2

The Department of Management and Budget did not provide adequate guidance to help entities determine whether bond proceeds could be used for computer and software costs.

The Department of Management and Budget's guidance on when computer purchases are eligible uses of bond proceeds is not clear. The department's guidance generally identifies computers as not being eligible costs, but also states that there may be instances when those costs are eligible. However, the guidance does not provide sufficient information about factors to consider in making the decision about whether computer purchases are eligible uses of bond proceeds. The department's 2010 *After the Bonding Bill* memo stated the following:

General obligation bond proceeds may only be used for qualified capital expenditures. Eligible costs include land acquisition, pre-design, design, construction, major remodeling (if it adds to the value or life of a building and is not of a recurring nature), and other improvements or acquisitions of tangible fixed assets of a capital nature.

General operating expenses, overhead, master planning, maintenance, operating costs, software and personal property such as computers are not qualified expenses. Equipment may be eligible if purchased and installed upon initial acquisition and construction of a building, expansion or major remodeling.

Expenses that are not qualified capital expenses must be paid from funds other than general obligation bond proceeds or from general fund cash if not prohibited by law.²⁰

Other guidance about the possible use of state general obligation bonds to fund technology projects is included in a July 2000 state bond counsel opinion. That opinion stated the following:

Routers, switches, transmitters, trays, racks, closet structures and other similar devices may not be financed with general obligation bonds on an individual or repair/replacement basis; however, if these items are part of technology infrastructure (not, for example, items such as personal computers that do not comprise an integral part of the building's technology system), they may be acquired as a component part of a general program that comprises a capital betterment.²¹

Both of these documents generally exclude computers from the costs that may be paid with bond proceeds, but also indicate that computers may be eligible if they comprise an integral part of the building's technology system or if purchased and installed upon initial acquisition and construction of a building, expansion, or major remodeling.

In the transactions we tested, we found entities used about \$770,000 in bond proceeds to purchase computers and software. The following examples illustrate that entities sometimes either did not understand or did not follow the Department of Management and Budget's guidance on when computers and software may—and may not—be purchased with bond money.

- The Department of Administration purchased computers and software, totaling about \$150,000 in the transactions we tested, for the Moose Lake Sex Offender Program Treatment Facilities project authorized in the 2010 bonding bill.²²

Parts of the purchase related to the security system (such as wiring, monitoring sensors, and the technical infrastructure components and software) are integral to the facility's technology system and would likely be considered eligible expenditures. However, the computers, software,

²⁰ The Department of Management and Budget, "After the Bonding Bill"—*The Next Steps*, issued March 29, 2010, page 6, section 7.

²¹ Leonard Rice, Dorsey & Whitney (bond counsel), letter to Peter Sausen, Minnesota Department of Finance, July 5, 2000. This opinion is titled, *General Obligation Bond Financing of Technology Projects* on the Department of Management and Budget's Web site at: <http://www.beta.mmb.state.mn.us/bond-opinion>.

²² *Laws of Minnesota* 2010, Chapter 189, section 18, subd. 5.

and inmate bracelets that are not fixtures of the building appear to be costs that cannot be paid with bond funds.

- The Department of Military Affairs used about \$61,000 to purchase desktop computers and software for a classroom training center. The \$5 million appropriation authorized in 2008 provided the first phase of funding for a homeland security and emergency management training center at Camp Ripley. The appropriation stated that it was for the following:

... to predesign, design, construct, furnish, and equip Phase 1 of a tier-3 homeland security and emergency management training and exercise center at Camp Ripley, which includes a classroom facility and several facilities for field response training.²³

The “furnish and equip” language in the appropriation law could be seen as authorizing the purchase of computers and software for the training classroom at Camp Ripley. However, since the computers and software were not integral to the facility’s technology system, using bond money to purchase them was not in compliance with the Department of Management and Budget’s guidance.

- The Minnesota State Colleges and Universities used about \$423,000, in the transactions we tested, to purchase computers, software, and technology infrastructure for a computer lab from the \$14,782,000 appropriation for North Hennepin Community College’s Center for Business and Technology. The appropriation had the following stated purpose:

To construct, furnish, and equip an addition to the Center for Business and Technology and to renovate existing space for classrooms and related space.²⁴

Again, the purchase of computers and software to “furnish and equip” the computer lab seems consistent with the language in the appropriation law, but not with the guidance established by the Department of Management and Budget.

- In addition to the examples above, the following entities purchased computers and software with bond money even though they were not integral to a facility’s technology system: Amateur Sports Commission (\$18,000); Department of Employment and Economic Development

²³ *Laws of Minnesota* 2008, chapter 179, section 15, subd. 3.

²⁴ *Laws of Minnesota* 2010, chapter 189, sec. 3, subd. 17 (b).

(\$62,000); Lake Superior College (\$6,000); Minnesota Zoo (\$43,000); and Saint Paul College (\$7,000).

Every entity that receives bond proceeds has a responsibility to use bond money in compliance with all legal requirements. Because the requirements can be complex, entities need clear guidance from the Department of Management and Budget to help them make well-informed decisions about the types of costs eligible to be paid with bond proceeds.

Recommendation

- *The Department of Management and Budget should clearly define the types of computer and software purchases and the conditions that must exist to allow those costs to be eligible for payment with bond proceeds.*

The Department of Management and Budget allowed some entities to use bond proceeds appropriated for capital projects without determining the sufficiency of money from other sources needed for the projects.

Finding 3

Minnesota Statutes require the department to determine the commitments and matching requirements for capital projects where the state appropriation or grant is not sufficient to complete the project. *Minnesota Statutes* 2013, 16A.502, states, in part, the following:

If a state appropriation or grant for a capital project or project phase is not sufficient, by itself, to complete the project or project phase, and thus requires a commitment from other sources:

- (1) The commitment, including any required match, must be in an amount that, when added to the appropriation or grant, is sufficient to complete the project or project phase; and
- (2) The appropriation or grant is not available until the commissioner [of the Department of Management and Budget] has determined that the commitment is sufficient.

To ensure compliance with this requirement, the department developed a policy (in 2001, and updated in 2005) that stated:

Before capital appropriations may be expended . . . sufficient documentation must be received and approved by the Minnesota Management & Budget (DOF) which shows that the recipient has complied with all matching requirements outlined in the

appropriation authorization and has all the necessary funds to complete the project.²⁵

The 2008, 2010, and 2012 *After the Bonding Bill* memos had some differing requirements for information needed by the department to determine that the commitment of other resources necessary to complete the capital project was sufficient. Each of the memos highlighted the statutory requirement and stated that agencies must include appropriate documentation when they submit the appropriation entry form requesting that the department activate the appropriation. The memos also stated that once the department approves the match, the appropriation will be activated. In the 2012 memo, however, it limited this requirement to only those “projects specifically earmarked in the bonding legislation where a match is required.” We think this too narrowly defines when a state appropriation “is not sufficient, by itself, to complete the project or project phase,” since some appropriation laws do not fully fund projects, but also do not designate specific match requirements.

In addition, in the 2012 *After the Bonding Bill* memo, the department delegated responsibility to determine the sufficiency of the commitment of other resources to entities that execute grants requiring such commitments. The department required the granting entity to submit an annual report (by July 30 each year) with specific information about the other funding needed for projects or grants executed during the preceding fiscal year. The department instructed the entities to retain evidence to show that the additional funding has either been received or committed, in case this information is requested by the department or our office. We do not think this delegation complies with the statutory requirement that the commissioner of the Department of Management and Budget determine the sufficiency of the commitment of other resources needed to complete capital projects.

Our 2008 audit and our 2012 follow-up review identified that entities were using money appropriated in the bonding bills without the department’s determination of the commitment of other money needed for the projects. We found similar exceptions in this audit.

For projects we tested at the following entities, the department had not determined the commitment of resources needed from other sources to complete the projects before it made available money appropriated for projects.²⁶ In total, we tested ten projects at seven entities that had matching requirements.

- The department allowed the Metropolitan Council to use appropriations of bond proceeds without determining a commitment of the council’s own

²⁵ Department of Management and Budget, Statewide Financial Policy 0302-02, *Capital Appropriations with Matching Requirements*.

²⁶ Our testing confirmed that the entities had met the projects’ match requirements.

bond proceeds. Through February 2013, the council had used about \$16.8 million of the \$21 million appropriated²⁷ for regional park development as part of its long range plan for regional recreation open space, required by *Minnesota Statutes* 2013, 473.147. Although not required in the appropriation law, the council's long range plan stated that it would provide, from sales of its own bonds, 40 percent of the money needed to implement the plan, and the capital budget requests it submitted to the state to obtain the state's 2008 and 2010 appropriations indicated that the council would use \$14 million from the proceeds of the sale of its own bonds to provide 40 percent of the funding needed for the proposed projects, totaling \$35 million.

In addition, the department did not determine that the federal government had authorized funding under the Urban Partnership Agreement, as required by *Minnesota Laws* 2008, Chapter 179, Section 17, subd. 2, before it made available \$16,672,000 appropriated by that law. Council staff told us they notified the department about the federal funding in a supplemental budget request, but the department did not determine the availability of the federal money by reviewing the federal grant.

- The department allowed the Department of Natural Resources to use the \$3 million appropriation to provide the state match for the critical habitat private sector matching account without determining that the private sector funding had been committed.²⁸ The statute specified that appropriations transferred to the critical habitat private sector matching account may be expended only to the extent that they are matched equally with contributions from private sources or by funds contributed to the state's nongame wildlife management account. The private contributions could be made in cash, property, land, or interests in land. According to the statute, appropriations transferred to the account that are not matched within three years from the date of the appropriation cancelled back to the source of the appropriation.

The department also allowed the Department of Natural Resources to use about \$59.8 million of bond proceeds appropriated for flood hazard mitigation grants without determining the commitment of other matching funds required by statute and specified in grant agreements.²⁹ State statutes governing the grant program limited the amount of the grants to no more than 50 percent of the total flood mitigation measures, except for

²⁷ *Laws of Minnesota* 2008, Chapter 179, Section 17, subd. 14 (a), and *Laws of Minnesota* 2010, Chapter 189, Section 16, subd. 4 (a), each appropriated \$10.5 million for "the cost of improvements and betterments of a capital nature and acquisition by the council and local government units of regional recreational open-space land in accordance with the council's policy plan as provided in *Minnesota Statutes*, section 473.147."

²⁸ *Minnesota Statutes* 2013, 84.943.

²⁹ *Laws of Minnesota* 2010, Chapter 189, section 7, subd. 3.

certain projects in the Red River Basin, which may be funded by the state up to 75 percent of the costs involved.³⁰

- The department allowed the Department of Employment and Economic Development to use about \$5.4 million for business development infrastructure grants without determining that grantees had committed matching funds, as required by state statutes.³¹ The statute authorizes the commissioner of the Department of Employment and Economic Development to make grants to counties or cities to provide up to 50 percent of the capital costs of public infrastructure necessary for eligible economic development projects. According to the statute, the county or city receiving a grant must provide for the remainder of the costs of the project, either in cash or in-kind contributions, which may include the value of site preparation other than the public infrastructure needed for the project.
- The department allowed the Public Facilities Authority to use the wastewater infrastructure funding program appropriation without determining that grantees had received funding commitments from the United States Department of Agriculture Rural Economic and Community Development Program, as required by state statutes.³² We tested four grants, totaling approximately \$3 million, where the federal government's commitment was between 35 and 50 percent of the project costs.

By not determining that matching money or other resources had been committed to fully fund the project, the department did not ensure that the project costs would be shared as intended by the Legislature.

Recommendation

- *The Department of Management and Budget should determine the sufficiency of matching funds for all capital grants and projects before making appropriations available, as required by state statute.*

Finding 4

The Department of Management and Budget did not verify that state agencies and grantees filed real estate declarations with the county on property purchased or bettered with bond proceeds.

The Department of Management and Budget's policy requires that state agencies and grantees file real estate declarations with the county, but the department did

³⁰ *Minnesota Statutes* 2013, 103F.161, subd. 2c and subd. 3.

³¹ *Minnesota Statutes* 2013, 116J.431.

³² *Minnesota Statutes*, 2013, 446A.072.

not have a process in place to ensure compliance with its policy.³³ Filing a real estate declaration protects the state's interest in the property by preventing the subsequent sale of the property without the approval of the commissioner. If a property is sold, state statute requires the repayment of some or all of any outstanding related bonded debt from the proceeds of the sale.³⁴ The department also needs copies of the declarations in order to comply with the state's tax compliance policies related to tax exempt bonds.³⁵

In 2010, in response to our 2008 audit finding on real estate declarations, the department began requiring entities that purchased property with state bond funds to file a copy of the declarations with the department. However, in our 2012 follow-up audit, we concluded the department did not have a way to ensure it had received copies of all required declarations from state agencies or grantees that used bond funds for real estate purchases and improvements. For example, it did not review real estate purchases or improvements recorded in the state's accounting system or review other capital project report summaries to identify all real estate purchases and improvements to compare to the copies of real estate declarations it received.

In its 2012 *After the Bonding Bill* memo, the department began requiring agencies that granted bond funds for capital projects to report details about the grants by July 30 each year. In its response to our 2012 follow-up audit, the department indicated it intended to use that report to verify it had received copies of all required real estate declarations. Despite the department's policies, we found the following exceptions during our audit.

- The Department of Natural Resources and the Metropolitan Council did not file the required annual reports with the Department of Management and Budget that lists the grants made for real estate purchases or improvements so the department could ensure that it received copies of declarations from grantees. The Department of Natural Resources granted \$5 million for land purchases from the Reinvest in Minnesota Wildlife Area Land Acquisition and Improvement appropriation and \$3 million from the Critical Habitat Match appropriation. The Metropolitan Council did not file the required reports for the council's priorities portion of its Regional Parks and Trails appropriations of \$10.5 million each in 2008 and 2010. We did not verify whether or not the grantees filed the declarations with the county.

³³ Department of Management and Budget, *Second Order Amending Order of Commissioner of Finance*, Section 7.02, issued March 9, 2010.

³⁴ *Minnesota Statutes* 2013, 16A.695.

³⁵ Department of Management and Budget Tax Compliance Policies and Procedures, June 19, 2012, section III A., states, "The department will maintain records of state assets or portions of assets financed with bond proceeds."

- The Metropolitan Council did not file a real estate declaration for property Metro Transit purchased partly from the Urban Partnership Agreement appropriation for a park and ride site. This was the only real estate purchase we tested. The council purchased the land with \$300,000 from the appropriation and \$1.2 million from federal funds, for a total of \$1.5 million.

Recommendations

- *The Department of Management and Budget should develop a system to track property purchased and improved with bond proceeds to ensure that entities and grantees file declarations with the applicable county to protect the state's interest. The system should include a review of transactions recorded in the state's accounting system or a review of capital project reports for entities and grantees that do not use the state's accounting system.*
- *The Department of Management and Budget should ensure agencies granting funds for capital projects submit the required reports on grants so the department can verify it has received copies of all required real estate declarations.*

Finding 5 Several entities had internal control weaknesses resulting in noncompliance with accounting and procurement policies and procedures.

Several of the entities we audited had weaknesses in their accounting or procurement processes that resulted in noncompliance with legal provisions or the errors in the accounting system.

- **Lack of Review of Invoices.** The Metropolitan Council did not require recipients of grants through its Metropolitan Regional Parks Capital Improvements Program to provide detailed documentation to support requests for reimbursement. State policy requires that entities review invoices to ensure that costs included on requests for reimbursement are related to the program and eligible uses of bond proceeds.³⁶ The council required that grantees submit a schedule of payments made to their vendors (including the vendor names, amounts, dates paid, and check numbers), but did not require grantees to submit invoices to support the costs included in the schedule.³⁷ The council paid grantees \$16.8 million from the 2008 and 2010 bonding bills.

³⁶ State of Minnesota Capital Grants Manual, June 2012, page 2.

³⁷ We did not request or test grantees' documentation to support the reimbursements paid by the Metropolitan Council.

In its response to this issue in our 2008 audit report, the council stated that it planned to verify supporting documentation on a sample basis to provide assurance that grant recipients complied with legal requirements. The council did not follow through on this plan.

- **Lack of Documentation for Grantees' Administrative Costs.** As part of its Reinvest in Minnesota Conservation Reserve Program, the Board of Water and Soil Resources used \$492,020 to provide 42 grantees with up to \$2,000 per easement for administrative costs related to easement purchases. The board determined that \$2,000 per easement was a reasonable amount to offset the grantees' administrative costs related to an easement purchase and did not require grantees to account for how they used the money. State policy requires that the board review invoices to monitor grantees appropriate use of bond proceeds.³⁸ In this case, the invoices would show how the grantee used the administrative part of the grant, for example, by detailing the personnel costs associated with grantee staff who worked on the easement purchase. By not adequately overseeing how grantees used the grant funds, the board limited its ability to hold the grantee accountable for the appropriate use of the grant money.

- **Implementation Costs in Excess of Statutory Limit.** The Board of Water and Soil Resources incorrectly paid the Reinvest in Minnesota Conservation Reserve Program's administrative grants (discussed in the prior bullet) from the account set up to pay for easement purchases rather than from the account set up for program implementation costs. Because of this error, the board did not realize that it had exceeded the appropriation limit on implementation costs by \$292,680. The appropriation law allowed the board to use up to 10 percent (up to \$2.5 million) of the Reinvest in Minnesota Conservation Reserve Program for implementation costs.³⁹ Although the board's executive director told us that he interpreted the limit on implementation costs to apply only to costs incurred by the board, we think that the following documents identify the administrative grants as implementation costs:
 - The 2008 board resolution number 08-84 that approved the administrative grants referred to the appropriation law authorizing that up to 10 percent of the appropriation could be used to implement the program.

 - The grant agreements with the soil and water conservation districts also stated that the grant was to provide administrative and technical assistance for local implementation.

³⁸ State of Minnesota Capital Grants Manual, June 2012, page 2.

³⁹ Laws of Minnesota 2008, Chapter 179, section 9, subd 2.

- **Lack of Documentation of Payment Approval.** The Department of Military Affairs did not have evidence of approvals on 5 of 24 payments we tested totaling \$42,050. State policy requires documented approval of invoices prior to payment to ensure the goods were received, that services were properly provided, and the invoice was not previously paid.⁴⁰
- **Payments in Excess of Contract Limits.** Minnesota State Colleges and Universities paid two contractors more than the amounts authorized in executed contracts.
 - North Hennepin Community College paid its owner's representative \$21,912 more than the contract authorized when the project required additional services and the work extended several months beyond the expected completion date. The chief financial officer approved a purchase order, and the college encumbered funds but did not execute a contract amendment.
 - North Hennepin Community College also paid a contractor \$382,510 for additional work in excess of executed contracts and amendments. The amendment authorizing the additional work was not fully executed and the college did not encumber money to pay for the additional work until three months after the additional work began. In this case, the college had prepared an amendment to the contract but, because the college had not signed the amendment, it was not valid. The Minnesota State Colleges and Universities policy requires contracts be amended whenever changes to the original contract are necessary and that all parties sign the amendments.⁴¹ State statute and Minnesota State Colleges and Universities policy requires that money sufficient to meet the obligation be encumbered in the accounting system as soon as possible after making an obligation.⁴²

Recommendations

- *The Metropolitan Council should obtain sufficient documentation from its grantees (for example, vendor invoices) to ensure the requests for reimbursement are for eligible project costs.*

⁴⁰ Department of Management and Budget, Statewide Financial Policy 0803-01, *Payment Requests, Preparation, and Approval*.

⁴¹ Minnesota State Colleges and Universities, *Project Management Manual for Design and Construction Projects*, revised August 2010, sections 9.3.2.1 and 9.3.4.1.

⁴² *Minnesota Statutes* 2013, 16A.15, subd. 3, and Minnesota State Colleges and Universities, Procedures 6.5.5, part 6 and 5.14.2, part 4. (Although not mentioned in the Minnesota State Colleges and Universities' procedures, the statute allows a construction project to proceed with supplemental work within the limits of the appropriation before money is encumbered. It also states that while the contractor is proceeding, the agency shall immediately act to encumber the required funds.)

- *The Board of Water and Soil Resources should 1) ensure that grantees use bond proceeds for eligible costs, 2) better define and accurately account for program implementation costs within the authorized limits, and 3) work with the Department of Management and Budget to determine if any repayment of bond funds is required.*
- *The Department of Military Affairs should document its approval of all payments.*
- *The Minnesota State Colleges and Universities should ensure its institutions fully execute contract amendments and obligate funds in the accounting system as soon as possible after making financial obligations.*

Several entities did not always submit information to the Department of Administration, certain members of the Legislature, or the Department of Management and Budget, as required by state statute or state policy.

Finding 6

For some of the projects we tested, entities did not comply with certain statutory and policy requirements to report information about the project. We tested the projects for compliance with the following statutory and state policy requirements, as applicable:

- *Minnesota Statutes 2013, 16B.335, subd. 1, states:*

The commissioner, or any other recipient to whom an appropriation is made to acquire or better public lands or buildings or other public improvements of a capital nature, must not prepare final plans and specifications for any construction, major remodeling, or land acquisition in anticipation of which the appropriation was made until the agency that will use the project has presented the program plan and cost estimates for all elements necessary to complete the project to the chair of the senate Finance Committee and the chair of the house of representatives Ways and Means Committee and the chairs have made their recommendations, and the chair of the house of representatives Capital Investment Committee is notified.

- *Minnesota Statutes 2013, 16B.335, subd. 3(c), states:*

A recipient to whom an appropriation is made for a project subject to review under subdivision 1 or notice under subdivision 2 shall prepare a predesign package and submit it

to the commissioner [of the Department of Administration] for review and recommendation before proceeding with design activities.

- Department of Management and Budget's policy *Regarding Use of General Obligation Bond Proceeds to Fund Staff Costs*,⁴³ issued October 20, 2009, and effective starting with the 2010 bonding bill, states:

Each agency must submit a report detailing the time expended on implementing capital projects to their respective EBO [the Department of Management and Budget employee assigned to the agency as its executive budget officer] on a quarterly basis. Each agency must certify that such time is properly capitalizable as a cost of the appropriate project in accordance with applicable accounting principles.

The following entities had exceptions to these reporting requirements for the projects we tested:

- The University of Minnesota did not submit project predesigns to the Department of Administration for both capital projects tested (the Physics and Nanotechnology and Itasca Facility Improvement projects).⁴⁴ The university's Office of Internal Audit concluded that the university lacked a process to ensure compliance with this statutory requirement.
- The Minnesota State Colleges and Universities did not submit project predesigns to the Department of Administration for two of five projects we tested. (Saint Paul College did not submit the information for the Transportation and Applied Science Building Addition and Renovation project and Bemidji State University did not submit the information for the Sattgast Science Building Addition and Renovation project.)
- The Department of Military Affairs did not submit project plans and cost estimates to the Senate Finance Committee and the House of Representatives Ways and Means Committee for its Camp Ripley Training and Exercise Center project. This was the only Military Affairs project we tested.

⁴³ This policy can be found on the Department of Management and Budget's Web site at: <http://tinyurl.com/mr3cayy>.

⁴⁴ To test compliance with these statutory requirements, the following University of Minnesota projects were tested that were not included in our initial scope: the Physics and Nanotechnology project authorized in *Laws of Minnesota* 2010, Chapter 189, section 2, subd. 3(b), and the Itasca Facility Improvement project authorized in *Laws of Minnesota* 2012, Chapter 293, section 2, subd. 4.

- The Board of Water and Soil Resources did not submit quarterly payroll reports to the Department of Management and Budget, as required by a department policy. The quarterly payroll cost reports allow the department to monitor if agencies' actual payroll charges corresponded with their approved plans and state policy. The board used \$69,636 from its 2010 easements appropriation to pay for staff costs. According to state policy, staff costs paid from bond funds must be directly related to the capital projects, and employees must daily track the time spent related to each project.

Recommendations

- *For projects to be financed with bond proceeds, the University of Minnesota and the Minnesota State Colleges and Universities should ensure they submit project predesigns to the Department of Administration.*
- *The Department of Military Affairs should submit project plans and cost estimates to the chairs of the Senate Finance and House Ways and Means committees before it proceeds with bond financed construction projects.*
- *The Board of Water and Soil Resources should ensure that it submits quarterly payroll cost reports to the Department of Management and Budget.*

Several entities incurred costs before the effective date of the bonding bills without notifying the Department of Management and Budget.

Finding 7

Five entities used money from bond proceeds to either pay for costs incurred, or to reimburse grantees for costs incurred, before the effective date of the bonding bills.

The Department of Management and Budget's 2008 *After the Bonding Bill* memo stated, "As a general rule, expenses that a grantee pays from its own funds prior to the effective date of the bonding bill are not eligible to be reimbursed from bond proceeds." The 2010 *After the Bonding Bill* memo extended the ineligibility of past expenses of grantees to also prohibit reimbursement of an agency's past expenses, stating, "As a general rule, expenses that an agency or grantee pays from its own funds prior to the effective date of the bonding bill are not eligible to be reimbursed from bond proceeds."⁴⁵

⁴⁵ Department of Management and Budget, 2008 and 2010 *After the Bonding Bill* memo, paragraph 4.

The memos further stated that before using bond proceeds to reimburse for past costs (as an exception to the general rule prohibiting this) entities must consult with department staff. The department needs this information to ensure that the use of bond proceeds to reimburse for past costs does not violate federal arbitrage rules or put the bond's tax-exempt status at risk.⁴⁶ Federal tax regulations limit the amount of bond proceeds that can be used for prior costs and have additional requirements if those limits are exceeded, such as requiring bond counsel to verify the prior costs met the eligibility requirements of the tax exempt bonds.

The following entities told us they did not consult with Department of Management and Budget staff before using bond proceeds for the projects we tested to pay for costs incurred before the effective dates of the bonding bills.

- The University of Minnesota reimbursed \$1.5 million in costs incurred prior to the effective date of the 2008 bonding bill.⁴⁷
- The Department of Employment and Economic Development reimbursed the Duluth Entertainment and Convention Center Authority for costs incurred prior to the effective date of the 2008 bonding bill. Because the invoices supporting those reimbursements identified a date range that spanned a period both before and after the effective date of the bonding bill, but did not identify when specific costs were incurred, we were unable to determine how much of the \$245,080 reimbursement was for prior costs.
- The Department of Natural Resources, Metropolitan Council, and Public Facilities Authority each reimbursed grantees for project costs incurred prior to the effective date of the related bonding bill totaling less than \$30,000.

⁴⁶ *Code of Federal Regulations*, Title 26, section 1.150-2, and Department of Management and Budget Tax Compliance Policies and Procedures, section II.D, dated June 19, 2012. The federal arbitrage regulations pertain specifically to reimbursement of paid prior costs.

⁴⁷ The 2008 After the Bonding Bill memo limited the notification to the Department of Management and Budget to reimbursements of grantee costs paid prior to the effective date of the bonding bill. However, in order to comply with IRS regulations for reimbursements of prior costs for tax exempt bonds, the Department of Management and Budget needed to be notified of reimbursements of all prior costs. As a result of our questions, the Department of Management and Budget reviewed the University of Minnesota costs and concluded they complied with the federal regulations.

Recommendations

- *The University of Minnesota, Public Facilities Authority, Metropolitan Council, and departments of Employment and Economic Development and Natural Resources should not use bond proceeds for project costs incurred prior to the effective date of the bonding bills without first consulting with the Department of Management and Budget.*
 - *The Department of Management and Budget should review the costs identified that were incurred prior to the effective date of the bonding bills and ensure they comply with federal regulations.*
 - *The Department of Management and Budget should consider the need to identify and review other costs incurred prior to the effective date of the bonding bills to ensure compliance with federal regulations.*
-

Appendix A Capital Projects Selected for Audit Testing

Entity Project Name	Bonding Bill Year	Appropriation Amount	Expenditures through 2/28/13
Administration⁴⁸			
Minnesota Correctional Facility Asset Preservation	2008	\$10,000,000	\$ 9,958,349
Minnesota Sex Offender Treatment Facility, Moose Lake	2010	47,500,000	45,375,332
Amateur Sports Commission			
National Volleyball Center - Rochester	2010	4,000,000	3,988,359
Board of Water and Soil Resources			
Reinvest in Minnesota Conservation Reserve Program	2008	21,250,000	14,854,404
Employment and Economic Development			
Duluth – DECC Arena	2008	38,000,000	38,000,000
Greater Minnesota Business Development Infrastructure Grant Program	2010	8,515,000	5,433,766
Metropolitan Council			
Urban Partnership Agreement	2008	16,672,000	16,596,915
Metropolitan Regional Parks Capital Improvements – Metropolitan Council Priorities	2008	10,500,000	9,993,497
Metropolitan Regional Parks and Trails Capital Improvements – Metropolitan Council Priorities	2010	10,500,000	6,816,661
Military Affairs			
Camp Ripley Training and Exercising Center ⁴⁹	2008	5,000,000	4,819,761
Minnesota State Colleges and Universities			
Bemidji State University - Sattgast Science Building Addition and Renovation	2008	8,900,000	8,900,000
Minnesota State University, Mankato - Trafton Science Center Renovation	2008	25,500,000	25,500,000
Saint Paul College - Transportation and Applied Technology Laboratories and Shops	2008	13,500,000	13,495,270
Higher Education Asset Preservation and Replacement	2010	52,000,000	51,924,100
Lake Superior College – Health Science Center	2010	12,098,000	11,614,592
North Hennepin Community College – Center for Business and Technology	2010	14,782,000	13,644,680
Minnesota Zoo			
Asset Preservation and Improvements	2008	2,500,000	2,500,000
Asset Preservation and Improvements	2010	6,000,000	5,732,663
Master Plan	2010	15,000,000	14,968,594

(Continued on next page)

⁴⁸ The Department of Administration managed several projects where the bonding bill named other state entities in the appropriation law.

⁴⁹ The appropriation to the Department of Public Safety directed the Department of Administration to administer this project; the Department of Administration transferred the \$5 million appropriation and management responsibility for the project to the Department of Military Affairs because the location of the project was on property owned by that department.

(Continued from previous page)

Entity <u>Project Name</u>	<u>Bonding</u> <u>Bill Year</u>	<u>Appropriation</u> <u>Amount</u>	<u>Expenditures</u> <u>through</u> <u>2/28/13</u>
Natural Resources			
RIM – Wildlife Area Land Acquisition and Improvement	2008	\$ 5,000,000	\$ 4,989,519
RIM Critical Habitat Match	2008	3,000,000	3,000,000
Flood Hazard Mitigation Grants	2010	63,500,000	59,813,300
Public Facilities Authority			
Wastewater Infrastructure Funding Program	2010	24,200,000	23,976,036
Transportation			
Local Bridge Replacement and Rehabilitation	2010	47,200,000	31,257,049
Rochester Maintenance Facility	2010	26,430,000	23,747,205
University of Minnesota			
Science Teaching Student Center	2008	48,333,000	45,332,418
Higher Education Asset Preservation and Replacement	2010	56,000,000	40,311,436
Folwell Hall Renovation	2010	<u>23,000,000</u>	<u>21,118,116</u>
Total		<u>\$618,880,000</u>	<u>\$557,662,022</u>

March 3, 2014

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

Dear Mr. Nobles:

We appreciate the opportunity to discuss with you and your staff the audit findings in the Report on General Obligation Bond Expenditures. When it comes to interpreting the constitutional and statutory requirements for projects, the analysis is not black and white but is determined on the specific facts for the project.

Except as otherwise noted, our response will address only the 2014 recommendations for the findings related to MMB, which are findings 1, 2, 3, 4 and 7. However, we will continue to work with agencies to ensure the findings in this report are implemented and proceeds are recovered for ineligible costs.

Since this audit commenced, we have reorganized MMB's staff responsible for addressing issues related to the capital budget and bonding requirements. Previously, one position had been responsible for preparing the capital budget and vetting the bondability of projects before passage of a bonding bill, as well as working with state agencies and other grantees to implement the bonding appropriations and ensuring compliance with the various rules post-passage. These responsibilities have now been split into two different positions, which will allow MMB to devote greater resources for addressing bondability issues on the front-end of the legislative process and for also ensuring compliance with the state constitutional and statutory requirements regarding the use of the state's bond proceeds after a bonding bill is passed.

Finding 1 – Entities used bond proceeds to pay for some ineligible costs.

Recommendations:

- *The entities cited in this finding should repay the bond proceeds fund for costs that did not comply with legal provisions for the use of bond proceeds.*
- *The entities and the Department of Management and Budget should assess the need to identify and repay the bond proceeds fund for similar types of ineligible costs not directly identified by our testing.*

Response:

We agree that it is important for state agencies and other grantees of state general obligation bond appropriations to understand the constitutional and statutory requirements that apply to these appropriations. To this end, we have published agency guidance explaining these rules and restrictions, which you recognize in the OLA report. We also remain committed to conducting periodic training workshops for state agencies and providing assistance on an ad hoc basis to state agencies and other grantees regarding the proper use of bond proceeds and appropriate levels of oversight.

Since publication of the 2012 *After the Bonding Bill* memo, MMB formalized its policy that bond proceeds cannot be used for moving and relocation expenses. This is now codified as Minnesota Management and Budget Statewide Operating Policy Number 0308-01, “*Moving and Relocation Expense for Capital Projects*,” in the state’s accounting system.

We are reviewing the eligibility of the costs identified in the report and have concluded that some of the costs in this finding were ineligible uses of the state’s general obligation bond proceeds. However, we are working with bond counsel and entities to clarify the eligibility of other costs. We will work with all entities that used bond proceeds on ineligible expenses to recover those costs.

We are currently in the process of filling a vacant position on MMB’s debt management team. The new hire will be responsible, in part, for reviewing bond fund expenditures on a sample selection basis. This position has been vacant for over a year due to challenges in the hiring process.

Finding 2 – The Department of Management and Budget did not provide adequate guidance to help entities determine whether bond proceeds could be used for computer and software costs.

Recommendation:

- *The Department of Management and Budget should clearly define the types of computer and software purchases and the conditions that must exist to allow those costs to be eligible for payment with bond proceeds.*

Response:

MMB takes issue with this finding. MMB’s guidance on the permissible “equipping” of a project funded with bond proceeds is already much more extensive than indicated by this audit. Further, MMB has consistently advised state agencies and other grantees on these rules. We appreciate the examples raised by the OLA as they show our process is working well. For example, both MMB and Minnesota State Colleges and Universities (MnSCU) reviewed the specific examples related to MnSCU’s projects and concluded that all of the identified expenditures were eligible uses of bond proceeds.

A large amount of ambiguity naturally exists in determining the bond eligibility of certain expenses, which is not limited to computers and software. The outcome of these analyses frequently depends on the nature and scope of a specific bond financed project, and MMB regularly counsels agencies and grantees on questions surrounding the bond eligibility of expenses.

In defining the bookends of what qualifies as a bond-eligible expense, MMB looks first and foremost to the bond counsel opinions dated April 24, 1989, March 15, 1990 and July 5, 2000, all publicly available on MMB's website. The principles set forth in these opinions frame our analyses; however, as bond counsel emphasized in the 2000 opinion, "*individual* projects and bonding bill language would need to be analyzed for compliance with constitutional principles" on a case-by-case basis (emphasis added).

In addition to these bond counsel opinions and ad hoc consultations, and as acknowledged in the report, MMB has made additional guidance pieces publicly available regarding the types of expenditures that can be financed with general obligation bond proceeds, including the *After the Bonding Bill* memos, the Capital Budget Instructions, and the Capital Grants Manual.

We will continue to look for additional opportunities to provide greater clarification on the eligibility of computers and software, while recognizing the large amount of grey area that is still a factor.

Finding 3 – The Department of Management and Budget allowed some entities to use bond proceeds appropriated for capital projects without determining the sufficiency of money from other sources needed for the project.

Recommendation:

- *The Department of Management and Budget should determine the sufficiency of matching funds for all capital grants and projects before making appropriations available, as required by state statute.*

Response:

In the 2012 version of MMB's *After the Bonding Bill* memo, which was distributed to agencies in June 2012, we indicated that beginning on July 30, 2012 and on every July 30 thereafter, each agency receiving bond proceeds must file a report with MMB indicating the name of the grantee, grant amount and location for each project funded wholly or in part with state bond proceeds during the previous fiscal year, and the method used by the agency to determine whether the match and full project funding was in place. We will make the process more consistent and will provide additional reminders to entities of their annual filing requirements with MMB. In addition, once the vacant position is filled, we will resume reviewing projects on a sample selection basis to ensure that agencies are verifying match and full project funding.

Furthermore, we are in the process of compiling a list of those existing statutory grant programs that require a local match component. We will develop a process that works for determining the sufficiency of the local match for these agency-administered programs. For example, the Public Facilities Authority (PFA) has proposed a process for certifying to MMB that full funding is in place for the grant and loan programs it administers, in accordance with the statutory requirements applicable to the PFA. MMB will continue to work with the PFA to formalize the process and will evaluate whether this process could be extended to other state agencies.

Finding 4 – The Department of Management and Budget did not verify that state agencies and grantees filed real estate declarations with the county on property purchased or bettered with bond proceeds.

Recommendation:

- *The Department of Management and Budget should develop a system to track property purchased and improved with bond proceeds to ensure that entities and grantees file declarations with the applicable county to protect the state's interest. The system should include a review of transactions recorded in the state's accounting system or a review of capital project reports for entities and grantees that do not use the state's accounting system.*
- *The Department of Management and Budget should ensure agencies granting funds for capital projects submit the required reports on grants so the department can verify it has received copies of all required real estate declarations.*

We will continue to collect the required declarations on an on-going basis. In addition, as mentioned in our response to finding 3 and as further spelled out in the 2012 *After the Bonding Bill* memo, we will provide additional reminders to agencies about their annual filing requirements to collect information about the grants entered into during the previous fiscal year. This information will be used to determine that we have received the required real property declarations.

Further, we have begun an internal evaluation as to whether MMB should implement an alternative method for monitoring state agencies' and other grantees' compliance with the requirement to file real property declarations.

Finding 5 – Several entities had internal control weaknesses resulting in noncompliance with accounting and procurement policies and procedures.

Recommendation:

- *The Board of Water and Soil Resources should 1) ensure that grantees use bond proceeds for eligible costs, 2) better define and accurately account for program implementation costs within the authorized limits, and 3) work with the Department of Management and Budget to determine if any repayment of bond funds is required.*

Response:

While this finding was not directed to MMB, we would like to address the specific findings regarding the Board of Water and Soil Resources (BWSR). Pursuant to the third recommendation to BWSR copied above, MMB and BWSR have concluded that the expenditures identified in the report do not need to be repaid. In determining the bond eligibility of any expense, one question is whether the cost can be capitalized as a project cost under generally accepted accounting principles. This determination is made based on the *nature* of the project and of the specific cost and not merely language used to describe the cost. Upon review of the grants cited in the audit report as part of the Board of Water and Soil Resources' Reinvest in Minnesota Conservation Reserve Program, the \$492,020 in grants to the Soil and Water Conservation Districts are capitalizable costs associated with the acquisition and development of perpetual easements. We will continue to work with BWSR on any questions that arise in the future with respect to the

proper interpretation of similar bonding appropriations and the proper documentation of project and administrative costs.

Finding 6 – Several entities did not always submit information to the Department of Administration, certain members of the Legislature, or the Department of Management and Budget, as required by state statute or state policy.

Response:

While this finding was not directed to MMB, we appreciate the issues that were raised by the OLA as they confirmed our perspective that there are instances of noncompliance with these statutes and policies. We will continue to emphasize to state agencies and other grantees the importance of complying with these rules as part of the capital bonding process.

Finding 7 – Several entities incurred costs before the effective date of the bonding bills without notifying the Department of Management and Budget.

Recommendation:

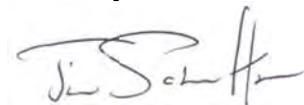
- *The Department of Management and Budget should review the costs identified that were incurred prior to the effective date of the bonding bills and ensure that they comply with federal regulations.*
- *The Department of Management and Budget should consider the need to identify and review other costs incurred prior to the effective date of the bonding bills to ensure compliance with federal regulations.*

Response:

As highlighted in the *After the Bonding Bill* memos, MMB has adopted a policy stating that expenses an agency or grantee pays from its own funds prior to the effective date of the bonding bill are not eligible to be reimbursed from bond proceeds, and instructs state agencies to consult with MMB on any reimbursement requests received by that agency. MMB will continue to reinforce this policy to agencies and grantees.

Again, thank you for the opportunity to discuss and respond to the audit findings of the department. We value the OLA's work to improve Minnesota's internal control structure.

Sincerely,



James Schowalter
Commissioner

February 20, 2014

Mr. James R. Nobles
Legislative Auditor
Office of the Legislative Auditor
Centennial Building, Suite 140
658 Cedar Street
St. Paul, MN 55155

Subject: Minnesota Department of Employment and Economic Development (DEED) response to Office of the Legislative Auditor on their audit of General Obligation Bond Expenditures

Dear Mr. Nobles:

The draft audit report has seven findings and we have determined that four of those findings relate to bonding grants that DEED administers. This letter contains our written response to those four findings.

FINDING 1 Entities used bond proceeds to pay for some ineligible costs

The finding indicates that DEED reimbursed the Duluth Entertainment and Convention Center Authority \$5,654 for costs that the OLA considered to be operating costs. On this grant DEED has excess match of \$1,408,871, so we would like to charge these ineligible costs as excess match.

FINDING 2 The Department of Management and Budget did not provide adequate guidance to help entities determine whether bond proceeds could be used for computer and software costs

The finding indicates that DEED reimbursed \$62,000 of computer and software costs of one of their grantees. In the future DEED will follow any process the Department of Management and Budget has in place to determine if computer and software costs can be reimbursed with bond proceeds.

FINDING 3 The Department of Management and Budget allowed some entities to use bond proceeds appropriated for capital projects without verifying the commitment of money from other sources needed for the project

The finding indicates that the Department of Management and Budget allowed DEED to use about \$5.4 million for Business Development Infrastructure grants without verifying that grantees had committed to matching funds, as required by state statutes. The statute authorizes the commissioner of DEED to make grants to counties or cities to provide up to 50 percent of the capital costs of public infrastructure necessary for eligible economic development projects.

Commissioner's Office

1st National Bank Building ■ 332 Minnesota Street ■ Suite E200 ■ Saint Paul ■ Minnesota 55101-1351
651-259-7119 PHONE ■ 800-657-3858 TOLL FREE ■ 651-296-4772 FAX ■ 651-296-3900 TTY ■ <http://mn.gov/deed>

AN EQUAL OPPORTUNITY EMPLOYER AND SERVICE PROVIDER

James R. Nobles
February 20, 2014
Page 2

DEED has only approved funding for projects that meet the 50 percent match requirement. DEED also requires grantees to report on total project expenditures and will not closeout a project that does not meet the 50 percent match requirement. If the Department of Management and Budget puts in place a process to verify the sufficiency of matching funds before making appropriations available, it will be adhered to by DEED for the Business Development Infrastructure Grant Program.

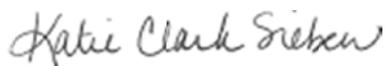
FINDING 7 Several entities incurred costs before the effective date of the bonding bills without notifying the Department of Management and Budget

The finding indicates that DEED reimbursed the Duluth Entertainment and Convention Center Authority for costs incurred prior to the effective date of the 2008 bonding bill. The audit report indicates that a portion of invoices totaling \$245,080 were reimbursed for costs incurred prior to the effective date.

DEED did seek approval from the Department of Management and Budget to reimburse these costs from 2008 bond proceeds and received oral approval. As we have no documentation of this approval, we would like to charge the \$245,080 of costs against the \$1,408,871 of excess match on this grant.

The Department of Employment and Economic Development appreciates the opportunity to respond to this draft audit report. DEED hopes that this additional information will be useful in drafting the final audit report.

My best regards,



Katie Clark Sieben
Commissioner

Commissioner's Office

1st National Bank Building ■ 332 Minnesota Street ■ Suite E200 ■ Saint Paul ■ Minnesota 55101-1351
651-259-7119 PHONE ■ 800-657-3858 TOLL FREE ■ 651-296-4772 FAX ■ 651-296-3900 TTY ■ <http://mn.gov/deed>

AN EQUAL OPPORTUNITY EMPLOYER AND SERVICE PROVIDER

February 21, 2014

James R. Nobles
Legislative Auditor
Office of the Legislative Auditor
Room 140 Centennial Building
658 Cedar Street
Saint Paul MN 55155-1603

RE: General Obligation Bond Expenditures – Internal Controls and Compliance Audit,
Metropolitan Council Management Response

Dear Mr. Nobles:

Enclosed please find the Metropolitan Council's management response to the general obligation bond expenditures audit conducted by your office.

As noted, the Metropolitan Council is mentioned in findings 3 & 4, with recommendations directed to the Department of Minnesota Management and Budget, and cited in findings 5 & 7, with recommendations directed to the Metropolitan Council. Our management response addresses each finding.

If you have need for further information, please contact me.

Sincerely,



Mary Bogie
Chief Financial Officer

Enclosure

cc: Susan Haigh, Chair

Finding 5: Several entities had internal control weaknesses resulting in noncompliance with accounting and procurement policies and procedures.

- Lack of review of Invoices. The Metropolitan Council did not require recipients of grants through its Metropolitan Regional Parks Capital Improvements Program to provide detailed documentation to support requests for reimbursement.

Recommendation: The Metropolitan Council should obtain sufficient documentation from its grantees, for example, vendor invoices, to ensure the requests for reimbursement are eligible project costs.

Council Response: The Metropolitan Council will require regional parks grantees to submit invoices, to support the cost included on their schedule of payments made to their vendors, with their requests for reimbursement.

Responsible Party: Arne Stefferud
Manager, Regional Parks and Natural Resources

Expected Resolved Date: Effective 1st Quarter 2014

Finding 7: Several entities incurred costs before the effective date of the bonding bills without notifying the Department of Management and Budget.

- The Metropolitan Council reimbursed grantee for project costs incurred prior to the effective date of the related bonding bill.

Recommendation: The Metropolitan Council should not use bond proceeds for project costs incurred prior to the effective date of the bonding bills without first consulting with the Department of Management and Budget.

Council Response: The Metropolitan Council will review supporting documentation (including invoices) included with requests for reimbursement to ensure project costs incurred prior to the effective date of the bonding bill are not reimbursed without first consulting with the Department of Management and Budget.

Responsible Party: Mary Bogie
Chief Financial Officer

Expected Resolved Date: Effective 1st Quarter 2014



DEPARTMENTS OF THE ARMY AND THE AIR FORCE

JOINT FORCE HEADQUARTERS MINNESOTA
OFFICE OF THE ADJUTANT GENERAL
20 12TH STREET WEST
SAINT PAUL, MN 55155-2004

February 10, 2014

The Adjutant General

James R. Nobles, Legislative Auditor
140 Centennial Office Building
658 Cedar Street
St. Paul, MN 55155-4708

Dear Mr. Nobles:

Thank you for the opportunity to review and respond to the recommendation outlined in the draft audit report of the state's general obligation bond expenditures. This is our written response to the audit findings and recommendations outlined in the draft audit report. We believe there was one typographical error in the document, and recommend the correction in the next paragraph.

Audit Finding 1

The Department of Military Affairs used \$23,511 for ineligible moving and relocation costs. Specifically, for a project at Camp Ripley, the department paid \$16,411 for delivery, removal, and rental fees for storage containers and semi-trailer containers, and \$7,100 for temporary office space for employees. The Amateur Sports Commission, the Department of Employment and Economic Development, the Department of Military Affairs, and the Minnesota Zoo used bond proceeds (\$4,259, \$3,620, \$4,060, and \$630, respectively, in the transactions we tested) for software subscription fees and warranties and computer maintenance and service agreements.

Audit Recommendations

The entities cited in this finding should repay the bond proceeds fund for costs that did not comply with legal provisions for the use of bond proceeds. The entities and the Department of Management and Budget should assess the need to identify and repay the bond proceeds fund for similar types of ineligible costs not directly identified by our testing.

Agency Response to Recommendation

The department concurs with the recommendation. The agency will work with MMB to reimburse the project bond account for ineligible expenses from the agency's general funds. The agency will implement a review process to detect ineligible expenses. However, we suggest that MMB revisit its 2012 After The Bonding Bill memo regarding moving and relocation costs as large construction projects can place a significant financial impact on operating budgets.

Person Responsible: CW3 Ben LaBelle, Comptroller, Department of Military Affairs
Estimated Completion Date: June 30, 2014

Audit Finding 5

The Department of Military Affairs did not have evidence of approvals on 5 of 24 payments we tested totaling \$42,050. State policy requires documented approval of invoices prior to payment

to ensure the goods were received, that services were properly provided, and the invoice was not previously paid.

Audit Recommendation

The Department of Military Affairs should document its approval of all payments.

Agency Response to Recommendation

The department concurs with the recommendation. The agency will update approval process to ensure that the agency retains the required documentation to support payments.

Person Responsible: CW3 Ben LaBelle, Comptroller, Department of Military Affairs

Estimated Completion Date: March 31, 2014

Audit Finding 6

The Department of Military Affairs did not submit project plans and cost estimates to the Senate Finance Committee and the House of Representatives Ways and Means Committee for its Camp Ripley Training and Exercise Center project. This was the only Military Affairs project we tested.

Audit Recommendation

The Department of Military Affairs should submit project plans and cost estimates to the chairs of the Senate Finance and House Ways and Means committees before it proceeds with bond financed construction projects.

Agency Response to Recommendation

The department concurs with the recommendation. In accordance with M.S. 16B335, the agency will implement new procedures to ensure that project plans and cost estimates are submitted to the chairs of the Senate Finance Committee and the House of Representatives Ways and Means Committee.

Person Responsible: Mr. Donald Kerr, Executive Director, Department of Military Affairs

Estimated Completion Date: May 30, 2014

Again, thank you for the opportunity to review and respond to the department's audit findings. If you have any further questions or concerns, please do not hesitate to contact me.

Sincerely,

/s/ Richard C. Nash

Richard C. Nash
Major General, Minnesota
Army National Guard
The Adjutant General

CF:
Donald Kerr, Executive Director
Ben LaBelle, Comptroller
David Polisen



February 10, 2014

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

Dear Mr. Nobles,

In response to the audit report on the State of Minnesota's use of general obligation bond proceeds, the Minnesota Amateur Sports Commission would like to submit its response to the findings specific to our agency.

Background

The Minnesota Amateur Sports Commission is a small agency that periodically receives capital bonding funds for various statewide sport projects. The agency historically has served primarily as a pass through agency for the administration of these funding requests. The agency works with the appropriate local government unit designated personnel and serves as a point of contact through the course of the project with the intent of making sure proper procedures are followed. However, it is also the responsibility of the local government unit to be due diligent in its administration of the approved bonding proceeds.

Upon completion of the bonding project, the standard protocol for our agency in processing the bonding expenditure reimbursement requests has been that the Executive Director reviews the payment reimbursement request(s) and submits the approved request to the agency's Fiscal Coordinator for final review/payment.

Audit Finding 1

General Obligation Bond Expenditures:

- Amateur Sports Commission authorized the use of bond proceeds in the amount of \$4,259 to be used for software subscription fees and warranties and computer maintenance and service agreements.
- The Amateur Sports Commission reimbursed the City of Rochester in the amount of \$15,935 for employee training. The costs included payment for employee's out-of-state travel costs and registration fees for training about the Best Value Procurement/Performance Information Procurement System.

Agency Response to Findings

Since both of the referenced findings relate to ineligible expenditures submitted by the City of Rochester for the Volleyball project, the response will be the same for both findings.

The agency's Executive Director will contact the City of Rochester's liaison and communicate the audit report findings along with the agency's response plan.

The agency will work with Minnesota Management & Budget/Small Agency Assistance and the City of Rochester in coordinating the repayment of the cited ineligible expenditures. The agency's Fiscal Coordinator will assume the responsibility for the oversight of this and will provide a status report to the agency's Executive Director.

The findings from the audit report will also serve as an educational tool going forward with future bonding projects whereby agency staff will take the initiative to work with MMB and its designated bonding personnel on attending appropriate training classes related to any future bonding bills; be more responsible in reviewing any and all written informational/educational communications that are available relating to this topic and will seek direction/guidance from the proper personnel when questions arise. The agency will also ensure that future bond recipients are aware of appropriate training opportunities and/or communications pertinent to their role in the bonding administrative process.

The agency's Executive Director and Fiscal Coordinator assures that all future bond payment requests will be thoroughly reviewed with the intent that the proper capital bonding guidelines are adhered to and that only authorized expenditures are approved for reimbursement. Staff will take the initiative to be more knowledgeable in all facets of the capital bonding procedural process.

It is our intent that the above stated response plan will help assure that future bonding appropriations and reimbursement requests are processed properly and adhere to the state's guidelines.

Please feel free to contact us if you have any further questions or need additional information. Thank you for your assistance.

Sincerely,

/s/ Paul D. Erickson

Paul D. Erickson
Executive Director

Cc: Alex Rowell, Chair



Minnesota
STATE COLLEGES
& UNIVERSITIES

March 4, 2014

Mr. James R. Nobles
Office of the Legislative Auditor
Room 140 Centennial Building
658 Cedar Street
St. Paul, MN 55155

Dear Mr. Nobles:

This letter responds to the audit of expenditures from general obligation bond proceeds authorized by the *Laws of Minnesota* 2008, chapter 179 and *Laws of Minnesota* 2010, chapter 189 and expended through February 28, 2013.

The Office of the Legislative Auditor performs a vital part of our financial assurance program through its audits of the various colleges and universities, as well as the system office. The Board of Trustees, Chancellor Rosenstone and all our presidents strive to maintain an environment of the highest professional standards. The work of your staff has helped test that environment and provide continuing assurance that state laws and internal control procedures are in place and in force at our colleges and universities. Given the size of the 2008 and 2010 capital program throughout the state, and with over \$347,000,000 appropriated to the system, we were particularly pleased that your report noted that adequate internal controls are evident in the system.

We have evaluated the audit's findings and have begun to alter policies and practices to accomplish necessary corrective actions and are processing those inappropriate expenses identified in current year programs. We are prepared to communicate any new guidance issued by the Department of Management and budget when it becomes available. On behalf of the presidents, financial and facilities management staff at each of the colleges, universities, and the system office, please extend our appreciation to the audit managers and audit staff responsible for the audit product.

Sincerely,

Laura M. King
Vice Chancellor – Chief Financial Officer

c: Steven Rosenstone, Chancellor
College and University Presidents
Chief Financial Officers



February 25, 2014

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

Dear Mr. Nobles:

We appreciate the opportunity to respond to your audit findings related to the use of general obligation bond proceeds.

Finding 1: Entities used bond proceeds to pay for some ineligible costs.

Operating Costs

The Minnesota Zoo used bond proceeds (\$630) for software subscription fees...and service agreements.

Recommendation:

- The entities cited in this finding should repay the bond proceeds for costs that did not comply with legal provisions for the use of bond proceeds.
- The entities and the Department of Management and Budget should assess the need to identify and repay the bond proceeds fund for similar types of ineligible costs not directly identified by our testing.

Response:

- The Zoo agrees with the finding and will repay these costs from our operating funds. We will also review our bond expenditures not tested as part of this audit for any similar ineligible expenses.

Best regards,

Lee Ehmke
Director/CEO

Minnesota Department of Natural Resources

500 Lafayette Road · Saint Paul, Minnesota · 55155-4037

Office of the Commissioner

651-259-5555



March 3, 2014

James R. Nobles
Minnesota Legislative Auditor
450 Cedar Street
St Paul, MN 55101

Dear Mr. Nobles:

Thank you for the opportunity to review and respond to your office's internal controls and compliance audit of General Obligation Bond Expenditures. The Department of Natural Resources (DNR) is specifically mentioned in two of your findings. Following are the Department's responses to those findings:

Finding #4. Minnesota Management and Budget (MMB) did not verify that state agencies and grantees filed real estate declarations with the county on lands purchased or bettered with bond proceeds. Beginning in 2012, MMB required agencies to annually report details concerning grant programs to the MMB, which intended to use the reports to help follow up on pending land declarations.

DNR Response. DNR will file the required reports by July 30 of each year as required.
Person responsible: Lisa Bell, Budget Accounting Officer, Office of Management & Budget Services

Finding #7. Grantees were reimbursed for costs incurred prior to the effective date of the bonding bill.

DNR Response. DNR will assure that this requirement is known to all program managers that manage bond funds by May 1, 2014. Person responsible: Lisa Bell, Budget Accounting Officer, Office of Management & Budget Services

Again, thank you for the opportunity respond to the draft report.

Sincerely,

/s/Tom Landwehr

Tom Landwehr
Commissioner





February 7, 2014

Mr. James R. Nobles
Legislative Auditor
Room 140, Centennial Office Building
658 Cedar Street
St Paul, MN 55155

Dear Mr. Nobles:

Please accept the following response regarding the findings and recommendations related to the Public Facilities Authority (PFA) in the draft audit report on expenditures of general obligation bond proceeds authorized by *Laws of Minnesota* 2008, Chapter 179 and *Laws of Minnesota* 2010, Chapter 189, and expended through February 28, 2013.

Finding 7: *Several entities incurred costs before the effective date of the bonding bills without notifying the Department of Management and Budget.*

Corrective Action Planned (CAP) in Response to Finding:

The Department of Management and Budget (MMB) was notified of these costs and the nature of the costs (pre-construction) during this audit.

For current and future disbursements from general obligation bond proceeds, PFA loan officers approving the costs will notify the PFA financial officer if any of the costs were incurred prior to processing of the PFA funding agreement with the entity. The PFA financial officer will review the source of funding used to ensure that the effective date of the applicable bonding bill is prior to incurrence of the costs. If not, the request will be returned to the loan officer pending MMB approval.

Official Responsible for Ensuring CAP is carried out:

PFA loan officers reviewing and approving project disbursement requests.
PFA Financial Officer reviewing the source of funding used for those requests.

Completion Date for CAP:

This corrective action plan has been implemented by PFA.

If you have any questions, please contact me at 651-259-7465.

Sincerely,

/s/ Jeff Freeman

Jeff Freeman
Executive Director

c: Katie Clark Sieben, PFA Chair
Steve Walter, PFA Financial Officer

Minnesota Public Facilities Authority
332 Minnesota St., Suite W820 • Saint Paul, MN 55101-1378 • USA
651-259-7469 • 800-657-3858 • Fax: 651-296-8833 • TTY/TDD: 651-296-3900
mn.gov/deed/pfa

An equal opportunity employer and service provider



Minnesota Department of Transportation

395 John Ireland Boulevard
Saint Paul, MN 55155

February 11, 2014

James R. Nobles
Legislative Auditor
100 Centennial Office Building
658 Cedar Street
St. Paul, Minnesota 55155

Dear Mr. Nobles:

Thank you for the opportunity to review and respond to the audit of the State of Minnesota's use of general obligation bond proceeds expended through February 28, 2013. This letter is the Minnesota Department of Transportation (MnDOT) response to the draft report issued by the Office of the Legislative Auditor.

Finding 1 – Entities used bond proceeds to pay for some ineligible costs.

Recommendations:

- *The entities in this finding should repay the bond proceeds fund for costs that did not comply with legal provisions for the use of bond proceeds.*
- *The entities and the Department of Management and Budget should assess the need to identify and repay the bond proceeds fund for similar types of ineligible costs not directly identified by our testing.*

Response: MnDOT believes strongly in financial integrity. MnDOT continues to refine and improve its internal control process and will address the finding in the following manner:

MnDOT has repaid \$24,770 to the bond proceeds fund on January 30, 2014 for costs that did not comply with legal provisions for the use of bond proceeds.

MnDOT has increased its oversight and review process in the area of general obligation bond funds with staff from its Safeguarding MnDOT Program.

Responsible Staff: Tracy Hatch, Chief Financial Officer

Implementation Date: February, 2014

Thank you for the opportunity to respond to your findings and recommendations. MnDOT will monitor the implementation to the successful resolution of these findings. Please contact Suzanne Thayer, Safeguarding MnDOT Manager, at 651-366-3941 with any follow-up questions or information.

Sincerely,



Charles A. Zelle
Commissioner of Transportation

February 3, 2014

James R. Nobles, Legislative Auditor
Office of the Legislative Auditor
Room 140 Centennial Building
658 Cedar Street, St. Paul, MN 55155-1603

Dear Mr. Nobles:

This letter is in response to the findings included in the recent audit conducted by the Office of the Legislative Auditor of selected capital and Higher Education Asset Preservation & Replacement (HEAPR) projects that were funded by the 2008 and 2010 bonding bills.

Audit Finding 6

The University of Minnesota did not submit project predesigns to the Department of Administration for both capital projects tested (the Physics and Nanotechnology and Itasca Facility Improvement projects). The University's Office of Internal Audit concluded that the university lacked a process to ensure compliance with this statutory requirement.

University of Minnesota Response

The University agrees with this audit finding and has implemented new procedures to ensure that information is submitted to the Department of Administration in accordance with Minnesota State Statute 16B.335. Capital Planning and Project Management (CPPM) has taken the following steps to ensure compliance with the requirement.

1. Implemented a predesign checklist that all planners follow that includes a step for submitting the predesign to the Department of Administration after the legislature has made an appropriation;
2. Implemented a requirement that both checklist and the notice letter are filed by the planner in Unifier, CPPM's project and document management system;
3. Implementing a training process with planners to ensure that 1 & 2 above are followed.

Audit Finding 7

The University of Minnesota reimbursed \$1.5 million in costs incurred prior to the effective date of the 2008 bonding bill.

University of Minnesota Response

The language in the 2008 *After the Bonding Bill* memo, which was in effect at the time the University made the reimbursement, only references grantees, not state agencies or the University as being required to notify MMB prior to reimbursing for costs incurred prior to the effective date of the bonding bill. The requirement for more broad notification was a change made in the 2010 *After the Bonding Bill* memo.

The University's practice going forward will be to not charge expenses to state bond funds for construction costs incurred prior to the bonding bill being signed by the governor. If it is necessary to do so, the University will notify and seek concurrence from Minnesota Management and Budget.

Thank you for your efforts and those of your dedicated staff.

Sincerely,



Pamela Wheelock
Vice President, University Services



Richard Pfitzenreuter
Vice President, CFO, and Treasurer

cc:

Eric Kaler, President

Gail Klatt, Associate Vice President – Audits

Suzanne Smith, Assistant Vice President, Capital Planning & Project Management

Brian Swanson, Assistant Vice President, University Services Finance

Carole Fleck, Director, Debt Management

James Schowalter, Commissioner, Minnesota Management and Budget



March 3, 2014

James R. Nobles, Legislative Auditor
Room 140 Centennial Building
658 Cedar Street
Saint Paul, Minnesota 55155

Dear Mr. Nobles:

Thank you for the opportunity to respond to the findings and recommendations included in the internal controls and compliance audit on General Obligation Bond Expenditures conducted by your office. Our response addresses findings 5 and 6, which relate to the Minnesota Board of Water and Soil Resources (BWSR).

Finding 5. Several entities had internal control weaknesses resulting in noncompliance with accounting and procurement policies and procedures.

- Lack of Documentation for Grantees’ Administrative Costs.
- Implementation Costs in Excess of Statutory Limit.

Recommendations

- *The Board of Water and Soil Resources should 1) ensure that grantees use bond proceeds for eligible costs, 2) better define and accurately account for program implementation costs within the authorized limits, and 3) work with the Department of Management and Budget to determine if any repayment of bond funds is required.*

Response

To ensure that the agency monitors its grantees appropriate use of bond funds, and that all costs being reimbursed are eligible, BWSR will require additional documentation from its grantees. We are confident in our Board’s determination that \$2,000 per easement is a reasonable amount to pay for easement delivery, and may in many cases underestimate the full cost. (In fact, a 1998 study conducted by the Management Analysis Division of the Minnesota Department of Administration concludes that the average implementation cost per easement in high volume Soil and Water Conservation Districts [SWCDs] is over \$2700 per easement, and that the average implementation cost per easement in low volume SWCDs is nearly double¹). We agree, however, that more detailed reporting and tracking is

¹Minnesota Department of Administration, Management Analysis Division, *Board of Water and Soil Resources, Conservation Easement Process Redesign*, issued November 1998.

<i>Bemidji</i>	<i>Brainerd</i>	<i>Duluth</i>	<i>Fergus Falls</i>	<i>Mankato</i>	<i>Marshall</i>	<i>New Ulm</i>	<i>Rochester</i>
403 Fourth Street NW Suite 200 Bemidji, MN 56601 (218) 755-2600	1601 Minnesota Drive Brainerd, MN 56401 (218) 828-2383	394 S. Lake Avenue Suite 403 Duluth, MN 55802 (218) 723-4752	1004 Frontier Drive Fergus Falls, MN 56537 (218) 736-5445	1160 Victory Drive South Suite 5 Mankato, MN 56601 (507) 389-6784	1400 East Lyon Street Marshall, MN 56258 (507) 537-6060	261 Highway 15 South New Ulm, MN 56073 (507) 359-6074	3555 9 th Street NW Suite 350 Rochester, MN 55901 (507) 206-2889
<i>Central Office / Metro Office</i>		520 Lafayette Road North		Saint Paul, MN 55155	Phone: (651) 296-3767	Fax: (651) 297-5615	
www.bwsr.state.mn.us		TTY: (800) 627-3529		An equal opportunity employer			

needed to account for the actual costs of acquiring conservation easements. BWSR has an electronic reporting system used to distinguish spending by grant and activity for other grants. Adding easement delivery grants to that existing reporting and tracking system or changes to the way that easement delivery grantees are reimbursed will address the Legislative Auditor's recommendation.

We acknowledge the Legislative Auditor's finding regarding the appropriation limit on easement implementation costs for the Reinvest in Minnesota Conservation Reserve Program, and that grants were made from the account set up to pay for easement costs. However, we disagree that the grants were incorrectly paid out of this account. Appropriation language has been inconsistent over time, often using the terms "administration" and "implementation" interchangeably. BWSR's method of allocating costs, however, has been consistent over several prior and subsequent appropriations.

BWSR has consistently operated with appropriation caps for the agency's costs for administering and implementing the program. Grants to SWCDs have been consistently assigned as part of easement costs, as they pay for activities directly related to acquisition of the easement. With this particular appropriation, the Department of Management and Budget for the first time divided the initial appropriation into two separate accounts, one for easements, and one for program implementation. Consistent with past practice, BWSR assigned its agency costs to the program implementation account and local SWCD grants to the easement costs account. Neither BWSR's agency costs nor activities paid for by the SWCD grants are entirely or even primarily administrative in nature. BWSR's agency costs include activities such as design and engineering, survey work, and construction management. SWCD costs include securing and providing copies of applicable deeds, developing conservation and vegetation plans with landowners, and assisting landowners with easement questions and forms. These costs are specific to and directly related to each acquisition.

We believe that BWSR's decision to pay the easement delivery grants from the easement account was proper and consistent. To act on the Legislative Auditor's recommendation, we will work with the Department of Management and Budget to determine if any retroactive reconciliation of bond funds is needed. We will also work with the Department to clarify definitions, and to establish accounts for the various components of project costs.

Persons Responsible: William Eisele, Administrative Services Director; Bill Penning, Easement Section Manager; Tim Dykstal, Fiscal Compliance Coordinator.

Estimated Implementation Date: July 2014.

Finding 6: Several entities did not always submit information to the Department of Administration, certain members of the Legislature, or the Department of Management and Budget, as required by state statute or state policy.

Recommendation

- *The Board of Water and Soil Resources should ensure that it submits quarterly payroll cost reports to the Department of Management and Budget.*

Response

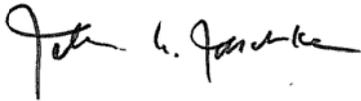
BWSR is adopting a supplemental time tracking system that will be phased in for fiscal year 2015. The addition of this tracking tool will help provide information in a consistent format across the agency. This information will be used for the quarterly payroll cost reports to the Department of Management and Budget.

Person Responsible: William Eisele, Administrative Services Director.

Estimated Implementation Date: July 2014.

We value the work by the Legislative Auditor's staff to evaluate our internal controls and fiscal compliance, and we appreciate their professionalism and the respect they accorded our mission and that of our local partners to advance conservation in Minnesota. Please let me know if you have any questions.

Sincerely,



John G. Jaschke
Executive Director

cc: Brian Napstad, BWSR Board Chair