



OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Financial Audit Division Report

Department of Health
Fiscal Year Ended June 30, 2004



Financial Audit Division

The Office of the Legislative Auditor (OLA) is a professional, nonpartisan office in the legislative branch of Minnesota state government. Its principal responsibility is to audit and evaluate the agencies and programs of state government (the State Auditor audits local governments).

OLA's Financial Audit Division annually audits the state's financial statements and, on a rotating schedule, audits agencies in the executive and judicial branches of state government, three metropolitan agencies, and several "semi-state" organizations. The division also investigates allegations that state resources have been used inappropriately.

The division has a staff of approximately forty auditors, most of whom are CPAs. The division conducts audits in accordance with standards established by the American Institute of Certified Public Accountants and the Comptroller General of the United States.

Consistent with OLA's mission, the Financial Audit Division works to:

- Promote Accountability,
- Strengthen Legislative Oversight, and
- Support Good Financial Management.

Through its Program Evaluation Division, OLA conducts several evaluations each year.

OLA is under the direction of the Legislative Auditor, who is appointed for a six-year term by the Legislative Audit Commission (LAC). The LAC is a bipartisan commission of representatives and senators. It annually selects topics for the Program Evaluation Division, but is generally not involved in scheduling financial audits.

All findings, conclusions, and recommendations in reports issued by the Office of the Legislative Auditor are solely the responsibility of the office and may not reflect the views of the LAC, its individual members, or other members of the Minnesota Legislature.

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If you have comments about our work, or you want to suggest an audit, investigation, or evaluation, please contact us at 651-296-4708 or by e-mail at auditor@state.mn.us

Department of Health

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Audit Participation

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

Claudia Gudvangen, CPA	Deputy Legislative Auditor
Jeanine Leifeld, CPA, CISA	Audit Manager
Ellen Sibley, CPA, CIA	Auditor-in-Charge
Steve Johnson, CPA, CISA	Senior Auditor
Totima To	Intern
Kristin Bentz	Intern

Exit Conference

We discussed the findings and recommendations with the following representatives of the Department of Health at the exit conference held on February 18, 2005:

Dianne Mandernach	Commissioner
Dave Hovet	Director of Financial Management
Janet Olstad	Assistant Division Director for Community and Family Health
Betsy Clarke	WIC Program Manager

Report Summary

Audit Findings:

- The department charged salaries to the WIC and CDC programs without documenting that the employees were actually working on those programs. The department also moved payroll costs between programs after the fact, without sufficient support. (Finding 1, page 3)
- The department did not account for and track fixed assets purchased with federal dollars. (Finding 3, page 5)
- The department did not verify that goods and services were received prior to paying invoices. (Finding 4, page 6)

The audit report contained four audit findings relating to internal control and legal compliance. Three of the findings were repeated from prior reports.

Audit Scope:

Programs material to the State of Minnesota's federal program compliance for fiscal year 2004.

Selected Audit Areas:

- Special Nutrition Program: Women, Infants and Children (WIC) (CFDA #10.557).
- Centers for Disease Control and Prevention (CDC) - Investigations and Technical Assistance (CFDA #93.283).

Background:

The WIC program provides supplemental food to low-income women and children. WIC expenditures totaled approximately \$66 million for the year. The Centers for Disease Control (CDC) Technical Assistance Program provides project grants for local disease prevention and control. Grants to the Department of Health include those provided under the Public Health Preparedness and Response to Bioterrorism Program. Federal Fund expenditures for this program totaled approximately \$26 million for the year.



Representative Tim Wilkin, Chair
 Legislative Audit Commission

Members of the Legislative Audit Commission

Ms. Dianne Mandernach, Commissioner
 Department of Health

We have audited certain federal financial assistance programs administered by the Department of Health as part of our audit of the state’s compliance with the requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2004. We emphasize that this has not been a comprehensive audit of the Department of Health.

Table 1 identifies the State of Minnesota’s major federal programs administered by the Department of Health. We performed certain audit procedures on these programs as part of our objective to obtain reasonable assurance about whether the State of Minnesota complied with the types of compliance requirements that are applicable to each of its major federal programs.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Table 1
Major Federal Programs
Administered by the Department of Health
Fiscal Year 2004 (in thousands)

<u>Program Name</u>	<u>CFDA #</u>	<u>Federal Expenditures</u>
Special Supplemental Nutrition Program for Women, Infants and Children (WIC)	10.557	\$66,402
Centers for Disease Control and Prevention (CDC)- Investigations and Technical Assistance ⁽¹⁾	93.283	\$26,361

⁽¹⁾ Includes the Public Health Preparedness and Response to Bioterrorism Program.

Note: We also audited the department’s cash management practices and other general compliance requirements related to federal assistance.

Source: Selected accounting transactions within the Minnesota Accounting and Procurement System (MAPS) for fiscal year 2004.

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Conclusions

Our November 19, 2004, report included an unqualified opinion on the State of Minnesota's basic financial statements. In accordance with *Government Auditing Standards*, we have also issued our report, dated November 19, 2004, on our consideration of the State of Minnesota's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. In March 2005, we will issue our report on compliance with requirements applicable to each major federal program and internal control over compliance in accordance with OMB Circular A-133.

As a result of our audit work, we identified the following weaknesses in internal control or instances of noncompliance with federal program requirements at the Department of Health:

Findings and Recommendations

1. PRIOR FINDING NOT RESOLVED: The department did not comply with federal and state requirements for documenting time charged to programs, including the transfer of payroll costs between programs.

The department did not adequately document the basis for payroll costs charged to the WIC (CFDA 10.557) and Centers for Disease Control (CDC) Technical Assistance (CFDA 93.283) programs. As a result, we were unable to determine if the department properly allocated payroll expenditures to the proper funding sources.

Payroll charges to specific programs must be supported by evidence that the employees, in fact, worked on those programs. The federal government addresses this issue in U.S. Office of Management and Budget (OMB) Circular A-87, *Cost Principles for State, Local, and Indian Tribal Governments*. The circular identifies standards for time distribution and payroll documentation for federal programs. The circular states that employees who work on multiple programs must have a salary distribution supported by personnel activity reports or equivalent documentation. This documentation must reflect the actual activity of each employee and account for the total activity for which each employee is compensated. In addition, where employees are expected to work solely on a single federal program, charges for their salaries must be supported by periodic certifications that the employees worked solely on that program for the period covered by the certification.

The department used both payroll expense transfers and expenditure corrections on a regular basis as a budgetary tool to transfer payroll costs between state and federal programs. However, support for these transfers was often inadequate. We noted the following specific instances of noncompliance relating to payroll funding documentation

- The department did not comply with federal requirements and department policy for documenting time charged to federal programs. Two of the six payroll expense transfers we sampled for CDC should have been supported by periodic certifications that the employees worked only on that federal program. However, there were no certifications on file for the employees. In addition, nine sample items involved employees working on

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either WIC or CDC, as well as on other programs. In order to change those employees' payroll funding, the department should have required time studies to support the hours the employees worked on each program. There were no time studies on file for these nine sample items.

- The department did not comply with the Department of Finance's policy for payroll expense transfers. According to the policy, "The mass expense transfer transaction is designed to correct a one-time funding problem. It is not to be used to correct a recurring problem." The department used mass expense transfers to retroactively move payroll costs between programs each year. Instead, the department should attempt to code all of its positions to the correct expense budgets at the beginning of each year, to minimize the need for retroactive adjustments.
- The department did not always document the reasons employee payroll funding changes were being requested. Eight of 15 requests for payroll expense transfers or corrections affecting the WIC and CDC programs did not provide sufficient detail about the purpose of the request. Sufficient documentation helps ensure that the transactions are consistent with state or federal requirements.

Using expense transfers and payroll expense corrections as a budgetary tool weakens controls designed to ensure that the department funded payroll in accordance with actual work performed and makes it difficult to determine if employees' time is charged to the appropriate funding source. Inaccurate and undocumented payroll funding could result in unallowable costs.

Recommendation

- *The Department of Health should comply with federal and state requirements for charging payroll to specific programs by:*
 - *establishing multiple funding sources for individual employees in SEMA4, as appropriate, to reduce the need for mass payroll expense transfers;*
 - *completing the periodic certifications for employees charged to a single federal program;*
 - *performing and documenting time studies when required; and*
 - *documenting the reason for transfers of payroll charges between funding sources and how the transfer is consistent with state or federal requirements.*

2. The Department of Health incorrectly coded certain expenditures on the state's accounting system.

The department did not generally enter the correct record dates when coding grant and administrative expenditures into MAPS, the state's accounting system. The department typically used the date it received the invoice as the record date, instead of the date it received the goods or services. A sample of 43 transactions showed that 42 sample items had incorrect record dates. The Department of Finance uses the record date to determine the state's outstanding liabilities at

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year-end for financial reporting purposes. Failure to use the proper record date could result in an understatement of liabilities in the state's financial statements.

Also, due to errors in the way the department entered information into the Contract Financial Management System, MAPS sometimes had the wrong date in the record date field. We reported last year that the department incorrectly showed contract payments as violations of Minn. Stat. Section 16A.15 in the contract management system. This statute requires the encumbrance of funds before the receipt of goods and services. By showing the payment as a violation, the record date defaulted to an incorrect date when the information transferred from the contract management system to the state's accounting system.

Recommendation

- *The department should ensure that it uses correct record dates when entering expenditures into the state's accounting system. It should follow the guidance provided by the Department of Administration for the proper recording of transactions in the Contract Financial Management System.*

3. PRIOR FINDING PARTIALLY RESOLVED: The Department of Health did not adequately manage its fixed assets.

The department did not adequately manage fixed assets purchased through federal CDC Investigations and Technical Assistance (CFDA 93.283) funding. We reported last year that the department did not record all fixed assets in its inventory records. The department did not always include the physical location of assets on the inventory lists. In addition, the department did not always include other important data in its inventory records, such as the funding source, date received, and estimated useful life. The department hired a fixed asset manager in June 2004 to ensure that the asset records are more complete.

The department had not performed a complete physical inventory of fixed assets in a number of years. According to federal regulations, the department should manage the equipment acquired under federal grants in accordance with state fixed asset procedures. The Department of Administration's Property Management Reporting and Accountability Policy, issued October 9, 2003, states that complete physical inventories for capital assets and sensitive items must be conducted, at a minimum, biennially.

Without complete and accurate fixed asset inventory records, the department is unable to adequately manage, track, and report fixed assets. The department may also be at risk of not complying with federal requirements when disposing of equipment acquired through federal funding.

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Recommendation

- *The department should improve its fixed assets management by maintaining a complete and accurate record of its fixed assets, including the funding source for fixed assets acquired through federal grants.*

4. The department processed payments without effective controls to ensure proper authorization of invoices.

The department had an inadequate process for approving invoices for payment. It did not require that the division responsible for ordering goods and services review and approve invoices prior to payment. Instead, the department's accounting division relied on purchase orders and receiving evidence, such as packing slips, as proof that goods had been received. However, it had no process to verify that services had been performed prior to payment. Fifteen of 29 invoices we sampled were not properly approved before payment. The department faces increased risk of inaccurate payments by not verifying that the goods and services had been received prior to paying invoices.

Department of Finance Operating Policy and Procedure Number 0102-01 requires that agency management ensure that payment requests are valid and that proper goods or services were provided. The approval of vendor invoices by division staff increases the assurance that incorrect charges will be detected and decreases the possibility of duplicate payments. Inaccurate payments could result in unallowable costs.

Recommendation

- *The Department of Health should improve controls over administrative expenditures by verifying that services were received prior to processing payments.*

This report is intended for the information of the Legislative Audit Commission and the management of the Department of Health. This restriction is not intended to limit the distribution of this report, which was released as a public document on March 3, 2005.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: February 1, 2005

Report Signed On: February 28, 2005

Status of Prior Audit Issues As of February 1, 2005

Prior Financial Audit Division Audits

March 11, 2004, Legislative Audit Management Letter (Report 04-19) examined the Department of Health's activities and programs material to the Single Audit for the year ended June 30, 2003. The scope included two federal programs: Special Supplemental Nutrition Program for Women, Infants and Children (WIC) and Centers for Disease Control and Prevention – Investigations and Technical Assistance. The report contained five findings. We repeated two of the prior issues as findings 2 and 3 in the current report. The department substantially resolved the other three findings.

May 24, 2004, Office of the Legislative Auditor Financial-Related Audit on Department of Health (Report 04-26) covered the period from July 1, 2000, through June 30, 2003. The audit scope was limited to grant and payroll expenditures and licensing receipts from healthcare-related facilities and service agencies. The report contained four findings. We repeated the finding relating to documenting time charged to programs as Finding 1 in the current report. We found that the department had resolved the finding regarding access to the state's payroll and personnel systems. The other two findings in the report were not relevant to our current objectives and, as a result, we did not pursue their status as part of this audit.

Other Federal Audit Coverage

August 2003 Report from the United States Department of Agriculture Midwest Regional Office reported results of a federal financial review of the Minnesota Special Supplemental Nutrition Program for Women, Infants and Children (WIC). The review focused on the verification of federal and state expenditures reported on the Financial Status Reports through second quarter, federal fiscal year (FFY) 2002. The review also looked at compliance with the Cash Management Improvement Act; rebates spend-forward activity; inventory and depreciation schedules of equipment purchased with WIC funds, the audits of local agencies; indirect cost rates; and the procedures followed to process single audits of local WIC agencies. The report noted one issue relating to proper internal control of equipment and assets by local agencies.

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

MDH

DEPARTMENT OF HEALTH

Protecting, maintaining and improving the health of all Minnesotans

February 24, 2005

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

Dear Mr. Nobles:

This letter is prepared in response to the draft audit report for the Minnesota Department of Health completed by your office for state fiscal year 2004.

Recommendation:

The Department of Health should comply with federal and state requirements for charging payroll to specific programs.

Response:

The department currently split codes positions in SEMA4 at the time a new position is created. In addition, the department annually, as part of preparing spending plans for the new year, reviews the staffing roster to ascertain the correct split on positions. The department does not have the available staff, nor sees the need, to adjust position allocation more often since costs are adjusted to time studies on a quarterly basis.

The department will also prepare and distribute to employees, a standard statement that can be used to certify 100 percent participation on a federal program.

The department will follow-up with the programs that are required to complete time studies to assure that a mechanism is in place so that time studies are completed on a timely basis. Furthermore, the department will be exploring options with other state agencies to propose modifications to SEMA4 that would make time entry easier for those employees that are in a multiple funded position.

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The department will require written explanation for the transfer of payroll charges between funding sources.

Recommendation:

The department should ensure that it uses correct record dates when entering expenditures into the state's accounting system. It should follow the guidance provided by the Department of Administration for the proper recording of transactions in the Contract Financial Management System.

Response:

The department concurs with the recommendation and has met with staff to correct the current misunderstanding for date of record. The department will also make the necessary adjustments to assure proper recording of transactions in the Contract Financial Management System.

Recommendation:

The department should improve its fixed assets management by maintaining a complete and accurate record of its fixed assets, including the funding source for fixed assets acquired through federal grants.

Response:

In June of 2004, the department filled a position dedicated to the management of fixed assets. The department has made progress in this area, fixed asset inventory has been adjusted to the \$5,000 level, items that have been discarded or replaced have been taken off the inventory, and a process has been put in place to identify assets at the time they are ordered. Additional steps will be taken this year to come into compliance.

Recommendation:

The Department of Health should improve controls over administrative expenditures by verifying that services were received prior to processing payments.

Response:

Currently, the department only has sufficient staff to process payments using a default standard that a payment is considered allowable unless otherwise instructed by program staff. The department will conduct a survey over the next few months of these administrative expenses to

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assess the level of risk for improper payments. Based on the survey, adjustments to the process will be made to the criteria of dollar amount or type of service.

I have assigned David Hovet, Director, Finance and Facilities Management, to carryout the actions necessary to comply with our responses.

Thank you for the respectful manner in which this audit was conducted and hopefully it was a good learning experience for your interns that were working on site.

Sincerely,

/s/ Dianne M. Mandernach

Dianne M. Mandernach
Commissioner
P.O. Box 64882
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