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**OFFICE OF THE LEGISLATIVE AUDITOR**  
STATE OF MINNESOTA

Financial Audit Division Report

**Minnesota State Arts Board**

**July 1, 2002, through June 30, 2005**



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## 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](mailto:auditor@state.mn.us)



## OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

Senator Ann H. Rest, Chair  
Legislative Audit Commission

Members of the Legislative Audit Commission

James Dusso, Interim Executive Director  
Minnesota State Arts Board

Members of the Minnesota State Arts Board

We conducted an audit of selected financial activities of the Minnesota State Arts Board for the period July 1, 2002, through June 30, 2005. Our audit scope included grants made to regional arts councils, art organizations, and artists. Our objectives focused on a review of the board's internal controls over these grant financial activities and its compliance with applicable legal provisions for grants. We emphasize that this has not been a comprehensive audit of the board.

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

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

*/s/ James R. Nobles*

James R. Nobles  
Legislative Auditor

*/s/ Cecile M. Ferkul*

Cecile M. Ferkul, CPA, CISA  
Deputy Legislative Auditor

End of Fieldwork: February 27, 2006

Report Signed On: May 19, 2006

# Minnesota State Arts Board

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### **Audit Participation**

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

Cecile Ferkul, CPA, CISA	Deputy Legislative Auditor
Brad White, CPA, CISA	Audit Manager
John Hakes, CPA	Auditor

### **Exit Conference**

We discussed the results of the audit with the following representatives of the Minnesota State Arts Board at an exit conference on May 10, 2006:

James Dusso	Interim Executive Director
Gail Burke	Human Resources Manager
Edward Oliver	Board Member

# Minnesota State Arts Board

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## Report Summary

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### Key Findings:

- The Minnesota State Arts Board paid grants to regional arts councils earlier than specified in law. (Finding 1, page 7)
- The board did not retain a portion of grants awarded to arts organizations and artists pending receipt of their final report. (Finding 2, page 7)
- The board did not disclose board members' grant affiliations in its 2004 and 2005 annual reports filed with the Legislature and the Office of the Governor. (Finding 3, page 8)

The current report contains three audit findings relating to grant controls and legal compliance. In follow-up of the prior audit, the board resolved one audit finding and partially resolved a second finding. Resolution of three other prior findings was not reviewed because they did not pertain to grant expenditures.

### Audit Scope:

Fiscal Years 2003-2005

#### Selected Audit Areas:

- Grants to Regional Arts Councils
  - Grants to Artists and Art Organizations
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### Background:

The Minnesota State Arts Board is composed of 11 members and has 9 employees. The board annually awarded about \$6 million grants to artists and art organizations and distributed \$2.4 million of state appropriations to regional arts councils.

# Minnesota State Arts Board

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# Minnesota State Arts Board

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## Chapter 1. Introduction

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The Minnesota State Arts Board's mission is to “*promote the quality of life in Minnesota by making the arts accessible to all citizens, nurturing creative activities, encouraging the development of innovative forms of artistic expression and preserving the diverse artistic heritage of the people.*” The board was established in 1976 and operates under the authority of *Minnesota Statutes* 2005, chapter 129D.

The board performs the following functions to accomplish its mission:

- administration of several grant programs that provide aid for a variety of activities in the performing, visual, and literary arts;
- distribution of state appropriations to the 11 regional arts councils in Minnesota; and
- administration of the Minnesota Percent for Art in Public Places program, in conjunction with the Department of Administration, to purchase or commission the creation of artwork for installation at newly constructed or renovated state buildings.

The board is composed of 11 private citizens appointed by the Governor to serve four-year terms. One member is appointed from each congressional district, with remaining members appointed at large. The board's daily management is the responsibility of the executive director. Currently, James Dusso serves as the board's interim executive director. The previous executive director, Robert Booker, served from August 1996 through November 2005.

The board received General Fund appropriations for administrative costs and grants. It also received federal funding from the National Endowment for the Arts. Other funding sources included grants from private organizations and miscellaneous receipts. Table 1-1 summarizes the financial activity of the board for fiscal year 2005.

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**Table 1-1  
Sources and Uses of Funds  
Fiscal Year 2005**

	<u>General Fund</u>	<u>Federal Fund</u>	<u>Special Revenue Fund</u>	<u>Gift Fund</u>	<u>Percent for Art in Public Places <small>(note 1)</small></u>
<b>Resources Available:</b>					
State Appropriations	\$8,593,000	\$ 0	\$ 0	\$ 0	\$280,695
Receipts	0	655,800	1,608	77,064	0
Balance Forward-In	4,458	217	680	338,774	0
Balance Forward-Out	<u>(3,303)</u>	<u>0</u>	<u>(583)</u>	<u>(315,783)</u>	<u>0</u>
Total Resources Available	<u>\$8,594,155</u>	<u>\$656,017</u>	<u>\$1,705</u>	<u>\$100,055</u>	<u>\$280,695</u>
<b>Expenditures:</b>					
Grants	\$8,193,458	\$214,017	\$ 0	\$ 29,500	\$ 0
Payroll	395,513	213,436	0	29,918	37,502
Other Administrative Costs	<u>5,184</u>	<u>228,564</u>	<u>1,705</u>	<u>40,637</u>	<u>0</u>
Professional Artist Services	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>243,193</u>
Total Expenditures	<u>\$8,594,155</u>	<u>\$656,017</u>	<u>\$1,705</u>	<u>\$100,055</u>	<u>\$280,695</u>

Note 1: State-appropriated capital projects provide funding to the board for the Percent for Art in Public Places Program. The measurement period for these activities was July 1, 2004, to June 30, 2005.

Source: Minnesota Accounting and Procurement System for fiscal year 2005.

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

## Audit Approach

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

To meet the audit objectives, we gained an understanding of the Minnesota State Arts Board's financial policies and procedures. We considered the risk of errors in the accounting records and noncompliance with relevant legal provisions. We analyzed accounting data to identify unusual trends or significant changes in financial operations. We also examined documents supporting the department's internal controls and compliance with laws, regulations, and contracts.

## Chapter 2. Grants

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### *Chapter Conclusions*

*The Minnesota State Arts Board's internal controls provided reasonable assurance that it authorized and accurately paid grants, properly recorded grant expenditures in the accounting system, and adequately monitored grants. However, the board paid the full award at the beginning of each grant instead of retaining a portion or prorating over the grant period. Retaining a portion of the grant creates a financial incentive for recipients to file final reports as required in their grant agreements. During the audit period, the board continued to receive final reports that were filed late.*

*For the items tested, the board awarded grants in compliance with significant finance-related legal provisions and the board's authorization. However, the board did not comply with certain legal requirements involving timing of grants paid to regional arts councils and disclosure of board members' grant affiliations in its annual reports.*

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### **Audit Objectives**

Our audit of grant expenditures focused on the following questions:

- Did the board establish internal controls to authorize and accurately record grant expenditures in the accounting records and to monitor grantees to ensure proper use of grant funds and compliance with provisions specified in grant contracts?
- Did the board award and disburse grants in compliance with significant finance-related legal provisions and board authorization?

*Minnesota Statutes* 2005, 129D.04 and 129D.045, authorizes the board to serve as fiscal agent to distribute state appropriations to 11 regional arts councils. *Minnesota Rules* 2005, 1900.2310 to 1900.4110, provides further requirements for eligibility, such as developing and filing biennial plans with the board. State appropriations are allocated based on regional population, and money is used by the regional arts councils for local arts projects, arts in education residencies, and general organizational support.

The board also provides a variety of grants to individual artists, schools, arts organizations, colleges and universities, and sponsoring groups that present arts activities. The requirements for selection and awarding of different types of grants are governed by *Minnesota Rules* 2005, chapter 1900, and involve volunteer advisors who review grant requests and make

## Minnesota State Arts Board

recommendations to the board. Board members meet bimonthly to provide final authorization on recommended grants.

During the three-year audit period, the board provided approximately \$29 million in grant funding to various programs, as shown in Table 2-1.

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**Table 2-1**  
**Grant Expenditures by Type**  
**Fiscal Years 2003, 2004, and 2005**

Grant Programs	2003	2004	2005
State - Regional Arts Councils	\$ 3,394,000	\$2,422,000	\$2,422,000
State - Institutional Support	6,657,931	5,013,000	4,973,800
State - Other Grants	1,265,697	749,542	797,658
Federal – NEA Grants	329,213	235,976	214,017
Private Grants	80,545	505,418	29,250
Total	<u>\$11,727,386</u>	<u>\$8,925,936</u>	<u>\$8,436,725</u>

Source: The Minnesota State Arts Board grants database and the Minnesota Accounting and Procurement System (MAPS) for fiscal years 2003, 2004, and 2005.

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The board awarded and disbursed state-funded grants for the following programs and purposes:

- ✓ **Regional Arts Councils** - The board acts as fiscal agent for the 11 regional arts councils in Minnesota. The board distributes the portion of its legislative appropriations designated to the councils using an allocation formula. The formula divides funds based on regional population using the 2000 census figures.
- ✓ **Institutional Support Program** – This program provides unrestricted operating support to nonprofit, tax-exempt arts organizations that produce or exhibit works of art, or offer a broad range of services to artists. During fiscal years 2004 and 2005, organizations must have had at least \$128,000 in annual operating expenses to be eligible for this support.
- ✓ **Other State Grants** – The board provides grants to individual artists and organizations through several programs, including Artist Assistance, Arts in Education, and Institutional/Presenter Support where presenters produce live public performances, exhibitions, or screenings in the visual, performing, and literary arts.

The board awarded federally funded grants it received from the National Endowment for the Arts. In addition, the board received private gifts from the Wallace Foundation and the Wells Fargo Minnesota Foundation.

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## Current Findings and Recommendations

### 1. The board paid grants to regional arts councils earlier than specified in *Minnesota Statutes*.

The board did not comply with legal timeframes involving grant payments to the 11 regional arts councils. *Minnesota Statutes* 2005, 129D.04, subd. 2 (4), requires, “*The annual report from the previous year must be on file at the board before distribution of appropriations to a regional arts council.*” Fiscal agreements with the regional arts councils call for a written report describing the activities relating to expenditures of their appropriation allocation on or before September 30 each year. Minnesota Rule 1900.4110 requires a variety of additional reports that also alert the board to council expenditures and use of their appropriated allocation. However, the board distributed funding to the regional arts councils in mid-July at the beginning of each fiscal year, before any of these reports were received.

#### *Recommendation*

- *The Minnesota State Arts Board should distribute appropriation funding to the regional arts councils after receipt of their annual report, as required by state law.*

### 2. **PRIOR FINDING PARTIALLY RESOLVED: The board did not retain a portion of grants awarded to individuals and organizations pending receipt of their final report.**

For institutional support and other state grants, the board did not establish cash management practices that were in the state’s best financial interest. As cited last audit, the board continued to disburse the entire grant amount to the recipient at the beginning of the grant period instead of prorating the disbursements over the grant period. In addition, not retaining a portion of the grant until the end of the grant period weakens the board’s ability to effectively ensure compliance with final grant reporting and close-out requirements. Without a financial incentive for grantees to timely submit close-out reports, the board loses its leverage to enforce the requirement. An effective practice typically used is to retain five or ten percent of the overall grant until all requirements are met.

The board requires detailed final reports from grantees to monitor use and spending of grant funds. However, as mentioned above, there is no financial incentive to file final reports in a timely manner. For 7 of 20 grants tested, recipients submitted the required final report to the board after the deadline specified in their grant agreement, one as late as six months. Board staff properly monitor whether grant reports are received; however, grant recipients continue to have difficulty filing timely final reports. The board has a moratorium list precluding any future grants due to failure to submit final reports.

## Minnesota State Arts Board

### *Recommendation*

- *The board should consider prorating grant payments throughout the grant period and retaining a portion of grants until grantees submit final reports.*

### **3. The Minnesota State Arts Board did not disclose board members' grant affiliations in its 2004 and 2005 annual reports.**

During 2004 and 2005, certain board and advisory committee members had affiliations with organizations receiving grants; however, these affiliations were not included in the board's annual report for those years. When board members have an affiliation, *Minnesota Statutes* 2005, 129D.02, subd. 5 (i), requires disclosure in the board's annual report to the Legislature and the Governor.

The Governor appoints private citizens to serve on the Minnesota State Arts Board and, at times, members may have a conflict of interest with organizations that are funded by the board. They may be employed by those organizations or serve on their board of directors. When this occurs, members submit a conflict of interest notice to the board chair and abstain from discussing and voting on any applications submitted by that organization. The affiliation should then be formally communicated in the board's annual report.

### *Recommendation*

- *The Minnesota State Arts Board's annual report should disclose board and advisory committee members that have affiliations with organizations receiving grants, as required by state law.*

# Minnesota State Arts Board

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## Status of Prior Audit Issues As of February 27, 2006

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**Legislative Audit Report 02-40**, issued in June 2002, covered the three fiscal years ending June 30, 2001. The audit scope included general financial management, grants, payroll, and the Percent for Art in Public Places Program. The report contained five audit findings. The board resolved one financial management finding and partially resolved a grants finding, which is repeated in Finding 2 of the current report. The remaining three issues did not involve grants and were not reviewed during the current audit.

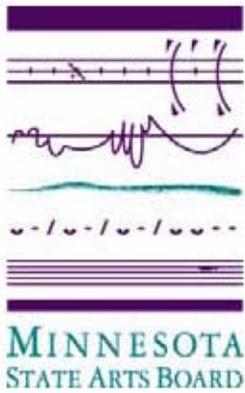
**Legislative Audit Report 03-50**, issued in September 2003, involved a special investigative review of employee payroll misappropriation. The board requested this review due to concerns that their accountant had processed payroll transactions for more hours than he actually worked and paid himself an unauthorized lump-sum salary payment. The audit concluded that \$3,258 was inappropriately paid, and the report was referred to the Attorney General and Ramsey County Attorney for recovery of state funds.

### State of Minnesota Audit Follow-Up Process

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

**Minnesota State Arts Board**

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May 15, 2006

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

Dear Mr. Nobles:

Please consider this letter as the Arts Board management's response to findings contained in the audit of selected financial activities of the Minnesota State Arts Board for the period July 1, 2002, through June 30, 2005.

I want to commend John Hakes of the Office the Legislative Auditor (OLA) staff for the cooperative and unobtrusive manner in which he conducted the audit fieldwork, Brad White for his support and professionalism in preparing the audit report, and Cecile Ferkul for the many helpful recommendations, observations, and suggestions that were offered at the exit conference. As a result of the efforts of these OLA staff members, the Arts Board's audit provided for a positive and productive process.

Concerning the first finding that the Arts Board paid grants to regional arts councils earlier than specified in state law. The board accepts the recommendation to distribute funds to the regional arts councils only after receipt of their annual reports. As noted in the audit, the Arts Board currently requires a number of periodic reports from each of the regional arts councils, none of which is identified as an annual report. At its May 24, 2006, board meeting I will initiate a discussion with board members to clearly define what it is required from each regional arts council in an annual report. In addition, I will clarify both with board members and with regional arts council staff that the Arts Board will not make grant payments to the regional arts councils until the Arts Board receives their annual reports.

Concerning the second finding that the board does not now but should consider prorating grant payments throughout the grant period and retain a portion of each grant until the grantee submits a final report. Because this was a prior recommendation the board did consider and continues to consider implementing a prorated grant payment structure. As in the past, the conclusion we continue

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to reach is that it would place a significant and undue hardship on the board's grantees, the very organizations and individuals the board was established to serve. In addition, with the significant administrative reductions experienced by the board beginning in 2004, any such addition in the board's grant payment structure would substantially increase the workload of an already overburdened staff, requiring us to reach beyond our current capacity. However, because of the continued importance placed on this recommendation, I will include this recommendation as an item on the agenda for the board's July 25, 2006, annual meeting.

Concerning the third finding that the board did not disclose board members' affiliations in its 2004 and 2005 annual reports and the recommendation that it should, as required by state law, include these affiliations in its annual reports. The Arts Board regrets the oversight of not including board member affiliations in the previous two annual reports. Sue Gens, the board's communications director, oversees the production of the board's annual reports and will work to insure that all subsequent reports disclose board and advisory committee members' affiliations with organizations and individuals receiving grants.

Sincerely,

A handwritten signature in black ink, appearing to read "James A. Dusso". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

James A. Dusso  
Interim Executive Director

JAD/gb

cc: Sue Gens, Communications Director  
Gail Burke, Human Resource Manager