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

Financial Audit Division Report

**Minnesota Department of Education**  
**July 1, 2002, through June 30, 2005**



September 28, 2006

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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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## 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

Ms. Alice Seagren, Commissioner  
Minnesota Department of Education

We conducted an audit of selected financial activities of the Minnesota Department of Education for the period July 1, 2002, through June 30, 2005. Our audit scope included license and fee revenue, payroll, purchases of supplies and equipment, and Native American Indian scholarships. Therefore, we emphasize we have not conducted a comprehensive audit of the department. Our objectives focused on a review of the Minnesota Department of Education's internal controls over these financial activities and its compliance with applicable financial-related legal provisions.

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

We would like to thank staff from the Minnesota Department of Education 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: July 18, 2006

Report Signed On: September 22, 2006

# Minnesota Department of Education

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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
Jim Riebe, CPA	Audit Manager
Jack Hirschfeld, CPA	Auditor-in-Charge
John Hakes, CPA	Auditor
Tim Rekow	Auditor
Jennifer Chapin	Auditor

### Exit Conference

We discussed the results of the audit with the following representatives of the Department of Education at an exit conference on September 12, 2006:

Alice Seagren	Commissioner
Chas Anderson	Deputy Commissioner
Tammy McGlone	Director of Administrative Services
Al Louismet	Accounting Operations Director

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## Report Summary

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### Overall Conclusion:

The Minnesota Department of Education's (Education) internal controls provided assurance that it correctly recorded employee payroll, fee and license receipts, and American Indian scholarship payments in the accounting system. However, we identified several findings with Education's internal controls or compliance with financial-related legal provisions, as follows.

### Findings:

- Education did not promptly deposit license and fee receipts, restrictively endorse checks upon receipt, or properly segregate receipt processing duties. (Findings 1 and 2, pages 6 and 7)
- The department did not give some employees timely performance reviews before authorizing salary increases as required. Also, the department did not adequately review payroll expenditures including hours paid and compensation rates. (Findings 4 and 5 respectively, pages 12 and 13)
- The department did not maintain adequate controls over fixed assets and did not comply with bidding requirements for some purchases. (Findings 6 and 7, pages 16 and 17)
- Education did not have adequate controls over the processing of American Indian scholarships. (Finding 8, page 20)

The report contained eight findings related to internal control and legal compliance.

### Audit Scope:

#### Audit Period:

July 1, 2002, through June 30, 2005

#### Programs Audited:

- License and Fee Revenues
- Payroll
- Purchases of Supplies and Equipment
- American Indian Scholarships

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### Agency Background:

The Minnesota Department of Education is responsible for establishing educational standards for grades kindergarten through twelfth grade. The expenditure programs covered in the scope of this audit totaled about \$34.9 million in fiscal year 2005. Fiscal year 2005 license and fee revenues amounted to about \$2.5 million. (We annually audit the department's largest expenditures, consisting of state and federal assistance to school districts, during the audit of the state's financial statements. Those programs totaled about \$6.6 billion in fiscal year 2005.)

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# Minnesota Department of Education

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## Chapter 1. Introduction

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The Minnesota Department of Education (Education) is responsible for establishing education standards for grades kindergarten through twelve and for processing federal and state financial assistance to school districts. It manages its subsidiary accounting systems, records federal grant receipts, and processes general education aid and federal grant payments to school districts. *Minnesota Statutes* 2005, Chapters 120-127A provides the authority and responsibilities for the Department of Education.

Education has approximately 400 employees in its Roseville office. Education serves a wide range of customers, including 850,000 pre-kindergarten through grade twelve students and their parents. The state has 339 school districts, 52,781 licensed teachers, 1,835 public schools, 82,000 adult learners participating in adult basic education, and 118,214 children participating in early learning programs. Governor Pawlenty appointed Alice Seagren commissioner of the department in September 2004.

The department consists of three divisions: School Improvement and Accountability; Academic Excellence and Innovations; and Finance, Compliance and Special Education, which includes the administrative services unit. The administrative services unit is responsible for the department's accounting and personnel functions and reports directly to the deputy commissioner.

Each year, as part of our audit of the state's financial statements and major federal programs, we audit the Department of Education's state and federal financial assistance to school districts. Financial assistance to school districts in fiscal year 2005 amounted to \$6.6 billion; major federal programs administered by the department totaled nearly \$500 million.

During the current audit, we focused on other financial operations of the department including license and fee revenues, payroll, supplies and equipment, and American Indian scholarships. Table 1-1 shows the financial activities for fiscal year 2005 included within our audit scope.

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**Table 1-1**  
**Fiscal Year 2005 Financial Activities Included in Audit Scope**

Employee Payroll	\$30,435,494
Purchases of Supplies and Equipment	2,538,276
License and Fee Revenue	2,463,234
American Indian Scholarships	1,905,337

Source: State of Minnesota Accounting and Procurement System reports.

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# Minnesota Department of Education

## Audit Approach

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

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 office'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,<sup>1</sup> as our criteria to evaluate agency controls. The standards also require that we plan the audit to provide reasonable assurance that the office 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 Department of Education's financial policies and procedures for the programs included within our audit scope. We considered the risk of errors in the accounting records and noncompliance with relevant legal provisions. We analyzed accounting data to identify unusual trends or significant changes in financial operations. We examined documents supporting the agency's internal controls and compliance with laws, regulations, contracts, and grant provisions.

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<sup>1</sup> The Treadway Commission and its Committee of Sponsoring Organizations (COSO) were established in the mid-1980s 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.

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## Chapter 2. License and Fee Revenue

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### *Chapter Conclusions*

*Education needs to improve controls over the processing of license and fee revenues by restrictively endorsing checks, more timely depositing receipts, and providing an independent review of deposits.*

*Education charged the appropriate amounts for license and fee receipts we tested.*

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### **Audit Objectives**

Our audit of license and fee revenues focused on the following questions:

- Did the department's internal controls provide reasonable assurance that license and fee receipts were safeguarded, accurately recorded in the accounting records, and in compliance with applicable legal provisions?
- For the items tested, did the department comply, in all material respects, with the significant finance-related legal provisions concerning licenses and fees?

### **Background**

Education collects various license and fee receipts. Table 2-1 shows the department's annual license and fees by type for fiscal years 2003 through 2005.

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**Table 2-1  
License and Fee Revenue  
By Fiscal Year**

	<u>2003</u>	<u>2004</u>	<u>2005</u>
Teacher Licenses	\$1,322,311	\$1,511,950	\$1,533,391
Administrator Licenses	135,749	161,357	159,869
Seminar and Workshop Fees	467,583	305,077	335,945
Career System Fees	601,745	461,501	434,029
Other Fees	<u>14,184</u>	<u>3,500</u>	<u>5,385</u>
Total Licenses and Fees	<u>\$2,541,522</u>	<u>\$2,443,385</u>	<u>\$2,468,619</u>

Source: Minnesota Accounting and Procurement System.

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Following is a description of the four types of receipts included in our audit scope.

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## Teacher Licenses

All public school teachers in the state are required to maintain active Minnesota teacher licenses. Education issues licenses costing \$57 for either, one, two, or five-year periods. The department's educator licensing and teacher quality unit processes the licenses. For the three-year period ending June 30, 2005, the department issued approximately 98,000 teacher licenses. Education conducts audits to identify unlicensed teachers by analyzing teacher databases populated by individual school districts. The department also charges an additional \$31 fee for background checks of first-time applicants. Education collects the fees for background checks and sends them weekly by mail to the Bureau of Criminal Apprehension.

## Administrator Licenses

Each school administrator must pay a \$75 annual fee to support the Board of School Administrators. The Board of School Administrators is part of the department's educator licensing unit but is at an offsite location. Board staff deliver these receipts to the Department of Education's Roseville office two to three times a week.

## Seminar and Workshop Fees

Each fiscal year, various divisions within the department conduct numerous conferences. Each division determines the fees for attending these conferences and sets fees to recover the costs of the conferences. Seminar and workshop receipts vary considerably between divisions and by workshop.

## Career Information System Fees

Individual school districts pay the department for access to a comprehensive career information system called the Minnesota Career Information System, part of a National Consortium called IntoCareers housed at the University of Oregon. The consortium is comprised of 18 states that share in the system's development. This system is designed to support life-long career planning and promote career self-reliance through assessment, exploration, goal-setting, and decision-making. The system is self-supporting and relies entirely on sliding scale subscriptions from schools.

## **Current Findings and Recommendations**

### **1. Education did not promptly deposit license and fee receipts, as required by statute, and did not restrictively endorse checks immediately upon receipt.**

Education did not deposit license and fee receipts and money received for teacher criminal background checks in a timely manner, as required by state statute. *Minnesota Statutes* 2005, 16A.275 requires agencies to deposit receipts daily when accumulating to \$250 or more. The department did not timely deposit 13 out of the 20 receipt transactions tested. In one instance, a \$28,000 seminar check was not deposited for over a month after it was written. Teacher and administrator license receipts were deposited between three and six days after receipt. Additionally, the license center held the fees for background checks and then mailed the receipts to the Bureau of Criminal Apprehension on a weekly basis, which further delayed the deposit of these funds. In general, the mailroom routed receipts and supporting documentation to divisions for processing before administrative services received and deposited the funds.

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Education's extensive routing of the various receipts resulted in late deposits. The department also did not restrictively endorse checks until they were sent to administrative services, which may be several days after initial receipt. Department of Finance policies<sup>2</sup> require agencies to restrictively endorse checks immediately upon receipt.

Education increases the risk that receipts may be lost or stolen by not restrictively endorsing checks at the time of receipt, routing checks to divisions for processing, and delaying deposits. A better system for collecting receipts would require that all receipts be collected by the cashier and deposited daily. Receipt information could be forwarded with the supporting documentation to the respective divisions for processing.

### *Recommendation*

- *Education needs to revise its receipt processing to ensure that it restrictively endorses checks upon receipt, and that it timely deposits all receipts in accordance with statutory provisions.*

## **2. Education did not properly segregate receipt processing duties to minimize the risk of errors or irregularities.**

Education did not separate incompatible duties for an account clerk who is responsible for processing receipts. The department assigned the account clerk responsibility for collecting receipts, recording receipts in the accounting system, and making the deposits. Generally, these functions should be separated to ensure that an employee is not in a position to conceal an error or irregularity. The risks of errors and improprieties diminish when incompatible duties are separated within an accounting cycle.

If incompatible duties cannot be adequately segregated, the department should mitigate this control weakness through better oversight and monitoring. For example, someone independent of the cashier function should be reviewing and approving deposits and receipt reconciliations. Department of Finance and Administration policy<sup>3</sup> states: "An independent employee must review and approve the daily deposits before making the bank deposit." The policy also requires that an independent employee reconcile the deposits to the accounting system monthly to ensure that receipts have been deposited in the correct amounts and correct accounts. By complying with these requirements, the department would strengthen its controls over receipts.

### *Recommendation*

- *The department should segregate incompatible receipt processing duties or provide an independent approval over daily deposits, and it should perform an independent reconciliation of deposits to the accounting system.*

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<sup>2</sup> Department of Finance and Administration Operating Policy and Procedure 0602-03.

<sup>3</sup> Department of Finance and Administration Operating Policy and Procedure 0602-03.

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## Chapter 3. Employee Payroll

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### *Chapter Conclusions*

*Education's internal controls provided reasonable assurance that payroll expenditures were accurately reported in the accounting records and complied with applicable legal provisions and management's authorization. However, the department needs to strengthen some controls over payroll processing by verifying biweekly payroll reports and restricting employees from authorizing their own timesheets.*

*For the payroll transactions we tested, the department complied with significant finance-related legal provisions except that it incorrectly charged employee severance payments as direct costs to certain federal programs. In addition, the department did not ensure that performance appraisals supported employee compensation increases, as required by the state's bargaining unit agreements and compensation plans.*

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### **Audit Objectives**

Our review of the department's payroll expenditures focused on the following questions:

- Did the department's internal controls provide reasonable assurance that payroll expenditures were accurately reported in the accounting records and complied with applicable legal provisions and management's authorization?
- For the items tested, did the department comply, in all material respects, with the significant finance-related legal provisions concerning payroll?

### **Background**

During the period July 1, 2002, through June 30, 2005, the Department of Education incurred payroll expenditures totaling approximately \$93.4 million. Table 3-1 shows payroll expenditures by type and fiscal year. As of April 2006, the department had approximately 400 employees. The employees belonged to various compensation plans, including the American Federation of State, County, and Municipal Employees; the Minnesota Association of Professional Employees; the Middle Management Association; the Commissioner's Plan; and the Managerial Plan.

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**Table 3-1  
Payroll Expenditures  
By Fiscal Year**

	<u>2003</u>	<u>2004</u>	<u>2005</u>
Full Time Employees	\$32,207,683	\$27,381,076	\$29,079,552
Part Time Employees	904,883	886,600	882,658
Overtime Pay	33,180	23,350	57,344
Premium Pay	24,618	25,745	26,446
Other Benefits	<u>937,069</u>	<u>566,661</u>	<u>389,494</u>
Total Payroll Expenditures	<u>\$34,107,433</u>	<u>\$28,883,432</u>	<u>\$30,435,494</u>

Source: Minnesota Accounting and Procurement System.

In October 2004, the department began using a new self service time entry process to enter hours worked and leave taken into the state's payroll system. Education was fully transitioned to the new system as of January 2005. The self service process automated employee timesheets and allowed for electronic supervisory approvals. Education used a standard exception report to monitor transactions when an employee did not enter their own time, or where the primary supervisor did not authorize hours worked.

Personnel and payroll responsibilities are shared by the Department of Education and two central oversight agencies, the departments of Employee Relations and Finance. The two oversight agencies maintain the central personnel and payroll system<sup>4</sup> used by all state agencies. The payroll system has numerous edits that ensure personnel and payroll transactions comply with legal provisions and terms of the compensation plans.

The commissioner of Employee Relations is the chief personnel and labor relations manager for the executive branch. In this capacity, the commissioner oversees a wide variety of functions, from negotiating compensation plans to maintaining the civil service classification system. To fulfill these duties, *Minnesota Statutes* give the commissioner the authority to further delegate certain responsibilities to individual state agencies. The Department of Employee Relations has delegated authority to the Minnesota Department of Education for certain human resources decisions and activities.

The conclusions reached in this report are based solely on work done at the Minnesota Department of Education. In addition, the Office of the Legislative Auditor also performed audit work to assess the adequacy of centralized personnel and payroll controls administered by the departments of Employee Relations and Finance. Legislative Audit Report #03-47, issued August 2003, focused on security controls that protect the integrity and confidentiality of data in the personnel and payroll system. It also assessed the adequacy of central controls over pay rates, leave accruals, and payroll processing. Due to the significance of payroll costs to the state, we continue to examine personnel and payroll controls and will be issuing another report to the departments of Employee Relations and Finance at a later date.

<sup>4</sup>State's Employee Management System (SEMA4).

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## Current Findings and Recommendations

### 3. Education charged some employee severance payments for sick leave and vacation directly to federal programs, which is prohibited by federal regulations.

Education erroneously charged nearly \$30,000 in employee severance payments for 13 federally-funded employees as direct costs to several federal programs. Federal regulations<sup>5</sup> require severance costs be charged as indirect costs in order to more effectively control federal expenses. Severance payments consist of payments to employees for sick and annual leave upon termination of employment. Table 3-2 indicates the federal programs that were incorrectly charged employee severance costs.

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**Table 3-2**  
**Federal Programs Incorrectly Charged Severance Costs**

<u>CFDA#</u>	<u>CFDA Name</u>	<u>Total</u>
93.938	School Health Programs	\$4,400
10.558	Child and Adult Care Food Program	\$3,120
10.560	State Administered Expenses Child Nutrition	\$2,179
84.002	Adult Education State Grant	\$1,364
84.010	Title I Grants to Local Education Agencies	\$179
84.027	Special Education Grants to States	\$13,833
84.181	Special Education Grants for Infants and Families with Disabilities	\$858
84.184	Safe and Drug Free Schools and Communities	\$494
84.186	Safe and Drug Free Schools and Communities State Grants	\$2,143
84.287	21 Century Community Learning	\$682
84.361	Voluntary Public School Choice	\$272
93.576	Refugee and Entrant Assistance	\$59
		<u>\$29,583</u>

Source: Department accounting records.

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Education initially sets up the payroll funding so that all federally-funded employees' biweekly payroll costs are charged directly to federal programs. Upon termination of employment, the department revises the funding source to the indirect cost accounts for severance payments made to employees who worked on federal programs. However, for the costs in question, the department failed to verify that it changed the funding source to the indirect cost accounts.

As a result of the audit finding, the department transferred the questioned costs to the indirect cost accounts, and we verified the accuracy of the transfers.

#### *Recommendation*

- *Education should verify that future severance payments for federally funded employees are correctly charged to the indirect cost plan.*

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<sup>5</sup> OMB Circular A-87, Attachment B Paragraph 11, (d), (3).

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### **4. Education did not give some employees timely performance reviews before authorizing salary increases, as required by state bargaining unit agreements and compensation plans.**

Supervisors did not evaluate some employees before approving salary increases, as required by state bargaining unit agreements and compensation plans. Three of five employees tested who were covered by bargaining unit agreements did not receive performance appraisals before receiving their salary increases. According to the bargaining unit agreements, employees must receive a satisfactory review before the employee's anniversary date at which point the employee is eligible for a salary increase. However, the bargaining unit agreements also provide that the department may not withhold salary increases due to untimely performance reviews. These employees' last reviews ranged from 13 months to three years before the effective date of the salary increases.

The department also did not provide timely performance appraisals for four of eight employees we tested who had received performance increases that were covered by the Managerial Plan. The Managerial Plan requires that the appointing authority certify that the employee has achieved performance standards or objectives in order to be eligible for salary increases. Pay rate increases based upon the employee's job performance should be supported by current performance appraisals.

#### *Recommendation*

- *Education should ensure that supervisors complete employee performance reviews before authorizing salary increases for employees.*

### **5. Education did not adequately review the hours paid and compensation rates processed by the payroll system.**

Administrative services did not review the payroll register as part of the biweekly processing of employee payroll as required by the Department of Finance's policy.<sup>6</sup> The payroll register documents all payroll amounts paid to the employee by pay period. A review of this report would ensure the accuracy of all payroll costs charged to the department, including salary pay adjustments, special payments, earnings codes, hours, pay rates, salary amounts, and lump-sum payments. Education did review a report it generates that documents the hours by type entered into the payroll system. This review verifies the accuracy of the input process but does not verify the hours actually processed by the payroll system or the detail by employee included in the payroll register.

Also, 11 department employees approved their own timesheets during fiscal year 2005. Within the self service time entry system, the department assigns a primary manager or supervisor and three to five secondary supervisors in each division to approve other employees' timesheets. If the primary approver is unavailable, the secondary supervisor approves employee timesheets. For the exceptions, the department established the employee also as the supervisor in the self service time entry system.

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<sup>6</sup> Department of Finance Policy PAY0028.

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State agencies are responsible for validating time entry records, reviewing records for accuracy, ensuring that errors are corrected, and approving each record according to state payroll policy.<sup>7</sup> If the department allows employees to approve their own timesheets, there is no validation of the time entry records. This situation increases the risk that employees could erroneously enter or falsify the time they worked or not report sick or vacation leave taken.

### *Recommendations*

- *Education should routinely review the payroll register to verify the accuracy of payroll costs charged to the department.*
- *Education should restrict employees from providing supervisory approval of their own timesheets.*

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<sup>7</sup> The SEMA4 Self Time Entry Overview.

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## Chapter 4. Purchases of Supplies and Equipment

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### *Chapter Conclusions*

*Education did not always follow required procurement procedures when purchasing supplies and equipment, and it did not maintain documentation supporting all supplies and equipment expenditures. Also, the department did not follow fixed asset inventory policies and procedures and did not perform a physical inventory.*

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### **Audit Objectives**

Our review of purchases of supplies and equipment focused on the following questions:

- Did the department's internal controls provide reasonable assurance that supplies and equipment expenditures were accurately reported in the accounting records and in compliance with applicable legal provisions and management's authorization?
- For the items tested, did the department comply, in all material respects, with the significant finance-related legal provisions concerning the purchases of supplies and equipment?

### **Background**

The Department of Education incurred supplies and equipment expenditures totaling approximately \$2.5 million in fiscal year 2005. Table 4-1 summarizes the expenditures for supplies and equipment during our audit period.

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**Table 4-1  
Supplies and Equipment Expenditures  
By Fiscal Year**

	<u>2003</u>	<u>2004</u>	<u>2005</u>
<b>Supplies</b>			
Supplies, Materials, and Parts <sup>(Note 1)</sup>	\$2,747,844	\$696,542	\$634,954
Computer related Parts and Supplies	0	0	142,275
Other Supplies	408	960	9,473
Total Supplies Purchases	<u>\$2,748,252</u>	<u>\$697,502</u>	<u>\$786,702</u>
<b>Equipment</b>			
Computers and Peripherals	\$1,238,848	\$1,376,807	\$1,206,677
Equipment	195,335	338,632	280,633
Capital Lease – Principal	296,504	0	0
Equipment Rental	8,492	15,699	163,444
Communications	45,993	21,351	100,821
Total Equipment Purchases	<u>\$1,785,172</u>	<u>\$1,752,489</u>	<u>\$1,751,575</u>
<b>Total Supplies and Equipment</b>	<u>\$4,533,424</u>	<u>\$2,449,991</u>	<u>\$2,538,277</u>

Note 1: In fiscal year 2003, the department erroneously coded equipment purchases in the accounting system as supplies, as explained in Finding 6.

Source: Minnesota Accounting and Procurement System.

State purchasing requirements are specified in *Minnesota Statutes* 2005, 16C.01 through 16C.35. The statutes delegate the authority for acquiring goods, services, and utilities needed by state agencies to the Department of Administration. The Department of Administration has further delegated purchasing authority to individual agencies, including the Department of Education.

The Department of Administration, as part of its statutory authority, developed procurement policies for general purchasing, contract purchasing, and emergency purchasing to assist agencies in managing their procurement function. The Department of Administration has also created an informational bulletin relating to agency property management reporting and accountability policies. The informational bulletin explains the procedures necessary to comply with the fixed asset inventory requirements.

Education has also established departmental policies that include purchasing procedures, contract purchasing, emergency purchasing, and fixed asset inventory. These policies were established to provide guidance to employees in administering procurement activities.

## Current Findings and Recommendations

### 6. Education did not have adequate controls over its fixed assets.

Education did not comply with the Department of Administration's policies and procedures for fixed assets. Fixed assets include equipment costing more than \$5,000 per item. The Department of Administration policies require state agencies to maintain inventory records listing all fixed assets and to complete physical inventories of fixed assets every two years. Education did not enter into the equipment inventory eight of eleven equipment purchases we

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tested. For instance, a computer server costing \$128,000 and projectors costing \$3,200 each were not recorded on the inventory listing. Education also did not properly record purchases of equipment in the accounting system in fiscal year 2003. At that time, the department incorrectly recorded approximately \$2 million of equipment purchases to supplies on the accounting system. Since fiscal year 2003, the department has implemented procedures to record equipment to the proper accounts.

The department also did not complete a physical inventory between fiscal years 2003 through 2006. This exceeds the two-year period required by the Department of Administration. Education's inventory policy states that the procurement unit is responsible for conducting the physical inventory of fixed assets. Education is aware of the inventory system issues and is in the process of updating its policies and procedures to specify the process for conducting the physical inventory.

### *Recommendations*

- *Education needs to ensure that all fixed assets are properly recorded on the fixed asset listing.*
- *The department needs to complete a physical inventory of its fixed assets and ensure one is completed every two years.*

### **7. The department did not follow certain procurement policies and procedures when purchasing supplies and equipment.**

Education did not always comply with the procurement policies and procedures. The department did not obtain bids or justify using a sole source provider for 6 of 23 purchases tested. The six purchases ranged from \$3,900 to \$148,000. The Department of Administration's policies<sup>8</sup> require state agencies to obtain competitive bids for purchases exceeding \$2,500. The policies also require state agencies to document the justification for a noncompetitive, single source procurement.

In addition, the department could not provide us with the supporting documentation for all transactions we tested; 7 of 29 samples tested were missing purchase requisitions, and 3 of the 30 samples tested were missing purchase orders. Purchasing requisitions are necessary to document authorization for the purchase and to support charging of costs to the correct appropriation. Purchase orders provide the terms of the purchase with the vendor and specify the items to be purchased. The department's purchasing policies require employees preparing a requisition for purchase to obtain their supervisor or manager's approval for the purchase. All orders are to be reviewed and approved by the procurement unit before placing the order. Since procurement responsibilities are delegated throughout the department, it is critical that the accounts payable staff ensures that all relevant purchasing procedures and documentation have been completed before paying invoices.

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<sup>8</sup> Authority for Local Purchase Manual, Section 2.

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### *Recommendations*

- *Education should comply with the Department of Administration's procurement policies and procedures. It should obtain and document the necessary bids or justify the use of a sole source provider when required.*
- *All departmental units should follow procurement policies and submit all purchasing documents to accounts payable for processing.*

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## Chapter 5. American Indian Scholarships

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### *Chapter Conclusions*

*Education's internal controls provided reasonable assurance that American Indian scholarships were accurately reported in the accounting records and complied with applicable legal provisions and management's authorization. However, the American Indian scholarship unit did not have sufficient controls over the processing of scholarships.*

*The department complied with the significant finance-related legal provisions concerning American Indian scholarships for the transactions we tested, except that it did not maintain complete five-year records of payments to students, as required by statute.*

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### **Audit Objectives**

Our audit of American Indian scholarships focused on the following questions:

- Did the department's internal controls provide reasonable assurance that American Indian scholarship expenditures were accurately reported in the accounting records and in compliance with applicable legal provisions and management's authorization?
- For the items tested, did the department comply, in all material respects, with the significant finance-related legal provisions concerning American Indian scholarships?

### **Background**

Minnesota has had a collaborative relationship with tribal governments and American Indian communities to support education for more than 50 years. In 1988, the Minnesota Legislature passed the Indian Education Act to formalize the state's commitment to supporting the unique cultural and academic needs of American Indian students. The American Indian Education staff at the Department of Education work to meet the intent of the legislation and to provide information and support to parents, students, teachers, and citizens, and by providing Minnesota American Indian scholarships. Education provides approximately \$1.9 million in scholarships each year.

Minnesota American Indian scholarships are available to eligible American Indian certificate, undergraduate, or graduate students who are enrolled full time or three-fourths time. In order to qualify for this scholarship, *Minnesota Statutes* 2005, 124D.84 requires that the students be:

- One-fourth or more of American Indian ancestry;

## Minnesota Department of Education

- Residents of Minnesota and members of a federally recognized American Indian tribe;
- High school graduates or GED certificate holders;
- Able to benefit from an advanced education;
- Accepted by an approved college, university, or vocational school in Minnesota; and
- Eligible to receive PELL or state grant funds.

Education has a procedure manual that describes the process for awarding the scholarships and determining the award amount. The procedural manual includes the dollar limits for the payment of awards, as shown in Table 5-1.

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**Table 5-1**  
**American Indian Scholarships**  
**Calculation of Award Amount**

<u>Program</u>	<u>Award Amount</u>
Certificate Programs	Students are eligible to receive \$1,000 per term and a maximum of \$3,000 per year.
Undergraduate Students	Students are eligible to receive one-half of their unmet need up to \$2,000 per term, with a maximum of \$4,000 per year.
Graduate Students	Students are eligible to receive up to one-third of their unmet need up to \$3,000 per term, and \$6,000 maximum per year.

Source: Indian Scholarship Procedural Manual.

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Students submit scholarship applications to the Department of Education. The department reviews the applications and submits the applications to the respective colleges' financial aid offices for processing. When the applications are returned, the department reviews the applications for student eligibility. If the student is eligible, the department calculates the payment amount and then notifies the student and the college of the award. One check is sent to each school for the total payment amount for all students receiving American Indian scholarships. Since funding is limited, the scholarship awards are processed on a first-come first-serve basis.

### Current Findings and Recommendations

#### **8. The Indian scholarship unit did not have sufficient controls over the processing and recording of American Indian scholarships.**

*Minnesota Statutes* 2005, 124D.84 provides the criteria for determining eligibility for scholarships. The Indian scholarship unit also maintains procedural and program guideline manuals that further explain the criteria and process for issuing awards and calculating the award amount. Education did not maintain adequate controls over the processing of scholarships, including:

## Minnesota Department of Education

- The Indian scholarship procedure manual and program guidelines are not current. Both documents refer to program activities that are outdated and no longer exist. In addition, the award amounts do not agree with current practice and do not reflect the awards issued. The Indian scholarship unit did not always determine scholarship payments in compliance with provisions of its procedure manual. The department provided payments that exceeded the approved amounts for four out of twelve scholarships we tested. For instance, the Indian scholarship unit awarded one student \$3,300 for spring term 2005, exceeding the amount approved in the procedure manual by \$1,300. Education needs to ensure its procedures manual reflects current practice.
- The Indian scholarship unit did not reconcile its payment records to expenditures on the state's accounting system. As of April 2006, the state accounting system expenditures exceeded the payment records by \$1,239. The Indian scholarship unit could not identify the reason for the difference. Reconciliations of the unit's accounting records to the state's accounting system helps to ensure that the proper expenditure amounts are recorded on the state's accounting system.
- *Minnesota Statutes* 2005, 124D.84 restricts scholarship payments to students to five years of study. The department did not maintain complete five-year records of student awards. Without adequate records, the department cannot monitor the payments and ensure it complies with the statutory requirement. The Indian scholarship unit has requested assistance from the department's information technology unit in developing a software program that will enable it to track payments to students.
- The department did not have the correct information on its scholarship applications. All three applications (certificate, undergraduate, and graduate) contained similar errors. The new student section of the application requires that documentation of American Indian ancestry must accompany the application only if the applicant is from a tribe "other than Minnesota Chippewa Tribe or Red Lake Band of Chippewa Indians." However, Minnesota statutes make no exception for certain tribes and require American Indian ancestry for all applicants.

### *Recommendations*

- *The Indian scholarship unit should revise its procedures manual and program guidelines and update the manual as needed. Also, scholarship applications should be consistent with statutes and the department's policy manual.*
- *Education should:*
  - *ensure that award amounts comply with its policies;*
  - *periodically reconcile its award amounts to expenditures recorded in the state's accounting system; and*
  - *maintain accurate records of scholarships amounts awarded to recipients.*

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## Status of Prior Audit Issues

As of July 18, 2006

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Each year the Financial Audit Division audits the Department of Education's federal and state grants to school districts because those activities are material to the state's financial statements. We also annually audit the department's compliance with federal program requirements. The audit covering the fiscal year ending June 30, 2005, did not report any findings.

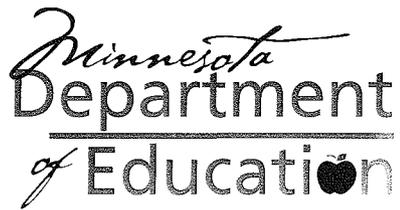
**Legislative Audit Report 05-15**, issued in March 2005, covered the fiscal year ending June 30, 2004. The report contained one finding related to the calculation of financial statement liabilities associated with federal program expenditures. The finding was resolved in fiscal year 2005.

**Legislative Audit Report 04-12**, issued in March 2004, covered the fiscal year ending June 30, 2003. The report contained nine findings related to federal program compliance and preparation of accurate financial statement information. All nine findings were resolved in fiscal year 2004.

### State of Minnesota Audit Follow-Up Process

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

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September 20, 2006

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

Dear Mr. Nobles:

Thank you for your audit of selected financial activities of the Minnesota Department of Education (Education) for the period ending June 30, 2005. I appreciate your staff's work on the audit report. We plan to implement all recommendations in the report with more specific detail provided in the following paragraphs.

#### Chapter 2 Recommendation 1

*"Education needs to revise its receipt processing to ensure that it restrictively endorses checks upon receipt, and that it timely deposits all receipts in accordance with statutory provisions."*

Education has started implementation of new procedures for handling cash receipts to address this recommendation. Recently, Education changed its policy and requires that all mail be opened in the mailroom. All checks will be restrictively endorsed upon arrival in the mailroom. Mailroom staff will deliver all cash receipts and application materials to the cashier for processing with a batch total for those receipts. The cashier will be responsible for making sure those receipts are then delivered to the bank within the 24 hour time frame required by statute and policy. No checks will be delivered to any staff by either the mailroom or cashier to be taken to the division. If there are questions regarding revenue received, that will be resolved without the actual check leaving the cashier.

In addition, Education will request a waiver pursuant to Department of Finance policy 0602-06 for license renewal periods to allow for additional time to process the cash receipt because of the increase in the number of transactions. If Finance grants that waiver, Education will follow the timeframe approved.

Education will also deposit the funds for the Bureau of Criminal Apprehension upon receipt in the state accounting system with a code block crediting the revenue to the Bureau. Education accounting staff is working with the Department of Finance to

establish this security clearance and the Department of Public Safety for code block information and to work out transaction processing details.

#### Chapter 2 Recommendation 2

*“The department should segregate incompatible receipt processing duties or provide an independent approval over daily deposits, and it should perform an independent reconciliation of deposits to the accounting system.”*

For Fiscal Year 2006, the agency finance staff did begin a reconciliation process that was outside the scope of this audit and not reviewed at this time. An accounting officer is doing a verification of daily cash receipts recorded by the cashier to the information entered into the state accounting system. We will be implementing this reconciliation process by creating more separation from those processing cash receipts and this individual by moving the responsibility and reporting to the agency audit director. That will allow for a separation of the reconciliation and review process from the supervision and authority of the cash management staff. Also, daily deposits will continue to be prepared by the department cashier but will be approved by the agency finance manager. Education will implement all aspects of this recommendation to assure adequate separation of duties is in place.

#### Chapter 3 Recommendation 3

*“Education should verify that future severance payments for federally funded employees are correctly charged to the indirect cost plan.”*

Education will implement this recommendation by providing more clear direction to payroll staff in the form of a written procedure for the processing of payments for employees upon termination or retirement. Also, in the process of notification from human resources staff to payroll staff that a vacation payoff or severance pay is to occur, staff will also communicate the requirement to change the default funding on those specific earnings codes.

#### Chapter 3 Recommendation 4

*“Education should ensure that supervisors complete employee performance reviews before authorizing salary increases for employees.”*

Education will implement this recommendation.

#### Chapter 3 Recommendation 5

*“Education should routinely review the payroll register to verify accuracy of payroll costs charged to the department.”*

*“Education should restrict employees from providing supervisory approval of their own timesheets.”*

Education will implement both of these recommendations. Staff under the direction of the audit director will review both the payroll register and the payroll posting audit trail on a bi-weekly basis to be sure that all payroll transactions for salary and business expenses are properly posted to accounts, use appropriate earnings codes and payment amounts are correct. Supervisor’s system access will be changed so that they are not authorized to approve payroll groups that their own timesheets process in.

#### Chapter 4 Recommendation 6

*“Education needs to ensure that all fixed assets are properly recorded on the fixed asset listing.”*

*“The department needs to complete a physical inventory of its fixed assets and ensure one is completed every two years.”*

Both of these recommendations will be implemented. Administrative Services will include inventory procedures in its purchasing policy and will assure that inventory information is maintained with appropriate internal controls and in compliance with state policy for fixed assets. In addition, a physical inventory will be taken of all assets and a schedule will be set for on-going physical inventory so that all property is accounted for every two years.

#### Chapter 4 Recommendation 7

*“Education should comply with the Department of Administration’s procurement policies and procedures. It should obtain and document the necessary bids or justify the use of a sole source provider when required.”*

*“All departmental units should follow procurement policies and submit all purchasing documents to accounts payable for processing.”*

Purchasing responsibilities will be centralized within the Administrative Services Division procurement staff with those certified purchasers responsible for compliance with Department of Administration’s procurement policies and procedures. Random reviews of procurement transactions will be implemented to assure all transactions are in compliance and that relevant materials are retained with purchase orders. In Fiscal Year

James Nobles  
September 20, 2006  
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2000 Administrative Services did change its filing procedures and has maintained purchase orders and receiving reports with invoices. We will require all procurement materials including bids and specifications to also be included with accounts payable invoice payment files.

Chapter 5 Recommendation 8

*"The Indian scholarship unit should revise its procedures manual and program guidelines and update the manuals as needed. Also, scholarship applications should be consistent with statutes and department's policy manual."*

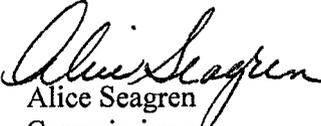
*"Education should:*

- ensure that award amounts comply with its policies;*
- periodically reconcile its award amounts to expenditures recorded in the state's accounting system; and*
- maintain accurate records of scholarship amounts awarded to recipients."*

The Indian Education program of the department will implement the recommendations in this report.

I appreciate the opportunity to implement the corrective actions for all recommendations made by your office in their review of some of the administrative processes of the department. If you have any questions, please contact Tammy McGlone at 651-582-8835.

Sincerely,

  
Alice Seagren  
Commissioner