



FINANCIAL AUDIT DIVISION REPORT

**Perpich Center for Arts
Education**

Internal Control and Compliance Audit

July 1, 2003, through June 30, 2007

October 9, 2008

Report 08-24

FINANCIAL AUDIT DIVISION

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State of Minnesota • James Nobles, Legislative Auditor

October 6, 2008

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Perpich Center for Arts Education

This report explains the results of our internal control and compliance audit of the Perpich Center for Arts Education (center) for the period July 1, 2003, through June 30, 2007.

Page 1 contains a Report Summary that presents our audit conclusions, key findings, scope and objectives, and background about the center. The Table of Contents indicates where to locate more detailed information about the audit within the report.

We discussed the results of the audit with center staff at an exit conference on September 25, 2008. This audit was conducted by David Polisenno, CPA, CISA, CFE (Audit Manager) and Susan Kachelmeyer, CPA, CISA (Auditor-in-Charge), assisted by auditors Zach Yzermans and Kayla Peterson. Our fieldwork ended on April 30, 2008.

We received the full cooperation of the center staff while performing this audit.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Cecile M. Ferkul

Cecile M. Ferkul, CPA, CISA
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Report Summary

Conclusion

The Perpich Center for Arts Education's (center) internal controls were not adequate to ensure that it safeguarded its assets, accurately paid employees and vendors in accordance with management's authorization, produced reliable financial information, and complied with finance-related legal requirements. For the items tested, the center did not comply with finance-related legal requirements over its financial activities. The report contains 17 findings related to internal control and legal compliance deficiencies.

Key Findings

- The center did not adequately fulfill its financial management responsibilities to control certain activities and ensure that it complied with state and center policies. ([Finding 1, page 7](#))
- The center did not adequately control access to the state's or the center's computerized business systems. ([Finding 2, page 8](#))
- The center did not adequately safeguard all receipts, separate incompatible duties in its receipt process, or reconcile recorded receipts to the deposit records. ([Finding 3, page 9](#))
- The center's internal controls were not adequate to ensure it accurately paid its employees. ([Finding 5, page 11](#))
- The center's internal controls over travel and other reimbursements were not adequate to ensure the accuracy of the reimbursements. ([Finding 6, page 12](#))
- The center did not establish sufficient internal controls or comply with legal requirements for the procurement of goods and services. ([Finding 9, page 14](#))
- The center did not properly administer its professional/technical service contracts. ([Finding 10, page 16](#))

Audit Objectives and Scope

Objectives

- Internal Controls
- Compliance

Period Audited

Fiscal Years 2004, 2005, 2006, and 2007

Programs Audited

- Payroll and Other Administrative Expenditures
- Selected Receipts

Background

The Center for Arts Education is an executive branch agency of the State of Minnesota. Its mission is to provide all Minnesota students the opportunity to develop and integrate their artistic and academic abilities to their highest potential. The center operates a public residential arts high school with enrollment limited to 310 11th and 12th grade students from throughout Minnesota. Approximately half of the student population resides in a dormitory on campus. The center provides resources to students, communities, educators, teaching artists, and school districts across Minnesota to improve the quality and access to arts education in the state.

Perpich Center for Arts Education

Agency Overview

The Perpich Center for Arts Education (center) provides arts education and resources to K-12 students and teachers. The center operates under *Minnesota Statutes* 2007, Chapter 129C. The center's board consists of 15 members appointed by the Governor with the advice and consent of the Senate. At least one member of the board must represent each of the state's eight congressional districts. The remaining seven members are at-large. The board appointed Nathan Davis as executive director in July 2005. The executive director is responsible for appointing a deputy and various other directors to manage the center's operations.

The center has three main areas of operations:

- The arts high school is a statewide, tuition-free, public high school for 11th and 12th grade students.
- The professional development and research area provides professional development training and technical support to communities, teachers, teaching artists, school administrators, and art organizations throughout Minnesota.
- The Perpich Center for Arts Education Library is an information and resource center for students, faculty, staff, and the general public.

General Fund appropriations provide the majority of the center's funding. For the four years audited, the center received appropriations of about \$6.6 million per year. The center also generated revenue from fees, sales of goods, grants, and donations. Payroll was the largest expenditure category. Table 1 summarizes the center's revenues and expenditures for fiscal years 2004, 2005, 2006, and 2007.

Table 1
Revenues and Expenditures¹
Fiscal Years 2004-2007

Revenues	Fiscal Years²			
	2004	2005	2006	2007
Student Fees	\$ 353,483	\$ 356,531	\$ 429,169	\$ 449,831
Grants/Donations ³	59,592	96,446	225,889	402,268
Sales/Other Income	79,402	96,086	121,920	87,384
Interest Earnings	<u>55,873</u>	<u>33,142</u>	<u>54,457</u>	<u>59,025</u>
Total	<u>\$ 548,350</u>	<u>\$ 582,205</u>	<u>\$ 831,435</u>	<u>\$ 998,508</u>
Expenditures				
Payroll/Personnel	\$4,763,731	\$5,038,309	\$4,922,937	\$5,156,684
Administrative Costs	1,990,715	1,339,595	1,104,582	1,626,674
Supplies/Equipment ⁴	335,821	621,399	393,108	714,723
Lease, Utilities, and Maintenance	387,131	448,291	448,429	442,951
Grants	272,126	391,301	272,109	270,449
Travel/Employee Development	<u>75,424</u>	<u>114,832</u>	<u>105,350</u>	<u>125,229</u>
Total	<u>\$7,824,948</u>	<u>\$7,953,723</u>	<u>\$7,246,515</u>	<u>\$8,336,710</u>

¹ The table does not include transactions related to employees' deferred compensation contributions. The center transmits amounts it deducts from employees paychecks to the 3rd party administrator. Although the center records these transactions on the accounting system, they are not the center's revenues or expenditures. The table also does not include internal fund transfers or student deposits.

² The state's fiscal year is July 1 through June 30.

³ During fiscal years 2006 and 2007, the center received a federal Department of Education Quality Teaching Grant. Reimbursements from the federal government under the grant totaled about \$444,000 over the two fiscal years.

⁴ The center purchased \$135,000 and \$91,000 of computer equipment and peripherals in fiscal years 2005 and 2007, respectively. In addition, the center's student food service costs increased significantly for part of fiscal year 2006 and all of fiscal year 2007.

Source: Minnesota Accounting and Procurement System as of December 31, 2007.

Objective, Scope, and Methodology

Our audit of the center focused on its material revenue and expenditure areas for the period July 1, 2003, through June 30, 2007. Our objective was to answer the following questions:

- Were the center's internal controls adequate to ensure that it safeguarded receipts and other assets, accurately paid employees and vendors in accordance with management's authorization, produced reliable financial information, and complied with finance-related legal requirements?
- For the items tested, did the center comply with significant finance-related legal requirements over its financial activities, including state and federal laws, regulations, contracts, and applicable policies and procedures?
- Did the center resolve its eight prior audit recommendations?¹

To answer these questions, we interviewed center staff to gain an understanding of the controls related to the center's financial operations. In determining our audit approach, we considered the risk of errors in the accounting records and potential noncompliance with finance-related legal requirements. We also analyzed accounting data to identify unusual transactions or significant changes in financial operations for further review. In addition, we selected a sample of financial transactions and reviewed supporting documentation to test whether the center's controls were effective and if the transactions complied with laws, regulations, policies, grants, and contract provisions.

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

We used various criteria to evaluate internal control and compliance. We used as our criteria to evaluate agency controls the guidance contained in the *Internal Control-Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission.² We used state and federal laws,

¹ Office of the Legislative Auditor, Financial Audit Division [Report 04-23](#), *Perpich Center for Arts Education*, issued June 10, 2004.

² The Treadway Commission and its Committee of Sponsoring Organizations were established in 1985 by the major national associations of accountants. One of their primary tasks was to identify the components of internal control that organizations should have in place to prevent inappropriate financial activity. The resulting Internal Control-Integrated Framework is the accepted accounting and auditing standard for internal control design and assessment.

regulations, and contracts, as well as policies and procedures established by the departments of Finance and Employee Relations and Administration and the department's internal policies and procedures as evaluation criteria over compliance.

Conclusions

The Perpich Center for Arts Education's internal controls were not adequate for payroll, receipts, and administrative expenditures. As a result, the center was not able to ensure it safeguarded its assets, accurately paid employees and vendors in accordance with management's authorization, produced reliable financial information, and complied with finance-related legal requirements.

For the items tested, the center did not comply with finance-related legal requirements over its financial activities.

The center resolved five audit findings from the prior audit report related to payroll, private and state grants, and its foundation. However, the center failed to resolve two internal control findings related to receipts and one compliance finding related to record retention.

The report contains 17 findings related to internal control and legal compliance deficiencies. The following *Findings and Recommendations* section further explains the exceptions noted above.

Findings and Recommendations

Finding 1

The center did not adequately fulfill its financial management responsibilities to control certain activities and ensure that it complied with state and center policies.

The center had significant internal control weaknesses, did not sufficiently document all transactions, and had instances of noncompliance with state finance-related legal requirements. As explained in findings 2 through 17, and recapped below, the center lacked a sound internal control structure to ensure that it safeguarded its assets, accurately paid employees and vendors in accordance with management's authorization, produced reliable financial information, and complied with finance-related legal requirements. Collectively, these weaknesses show an overall lack of proper administrative oversight by the center. The center's business office focused on processing financial transactions and did not adequately perform control procedures.

- The center did not adequately control access to the state's or the center's computerized business systems. ([Finding 2](#))
 - The center did not safeguard its receipts, segregate incompatible receipt duties, or reconcile the receipts collected to supporting documentation or the state's accounting system. ([Finding 3](#))
 - The center did not notify law enforcement, the Office of the Legislative Auditor, or other agencies about thefts, as required by statutes. ([Finding 4](#))
 - The center did not have adequate controls in place to ensure that it accurately paid its employees for work performed, or reimburse them for business-related travel expenses. ([Findings 5 and 6](#))
 - The center did not comply with collective bargaining agreements for hiring and performance increases. ([Findings 7 and 8](#))
 - The center did not retain documentation, approve purchase orders and special expense forms, encumber funds prior to incurring an obligation, and pay vendors in a timely manner for some of its administrative expenditures. The center also inappropriately entered into a credit relationship with a vendor. ([Findings 9, 11, and 17](#))
-

- The center did not properly administer its professional/technical service contracts, such as using the wrong contract form, lacking supporting documentation, preventing work from starting until the contract was fully executed, and verifying if vendors were suspended or debarred by the state. (Finding 10)
- The center did not always record transactions correctly in the state's accounting systems. (Findings 12 and 13)
- The center did not adequately monitor personal use of state cellular phones and employee travel-related benefits. (Findings 14 and 15)

Recommendation

- *The center needs to review its financial operations and implement controls to ensure transactions are accurate, properly approved, documented, and in compliance with state and agency policies.*

Finding 2

Prior Finding Not Resolved: The center did not adequately control access to the state's or the center's computerized business systems.

The center used the state's personnel, payroll, and accounting systems to process its financial transactions. It also used its own computer subsystem for receipts to supplement the information recorded on the state's computer system. The center had the following weaknesses in its administration of employee access to the computerized business systems:

- The center gave two employees incompatible security access in the state's payroll system that allowed them to change other employees' direct deposit information without authorization.
- The center did not remove two former employees' access in the state's online time entry system after they left employment with the center.
- As noted in the prior audit, the center did not appropriately limit access to its accounting subsystem. Two employees had incompatible access to its accounting subsystem. These employees had unnecessary access to the "edit accounting" function within the subsystem, which allowed the employees to change recorded information.

Segregation of incompatible duties is a fundamental internal control designed to prevent, or timely detect, errors or irregularities from being processed in the accounting system. State policy requires that agencies limit system access to only

those duties essential to a position's responsibilities.³ If it is not feasible to segregate duties, the Department of Finance and Employee Relations' policy⁴ requires that state agencies develop a written plan identifying compensating controls.

Recommendations

- *The center should eliminate incompatible employee access to the computer systems or develop, document, and monitor mitigating controls that provide independent scrutiny and review of the activity processed by those employees.*
- *The center should remove all access to its computer systems when employees leave employment.*
- *The center should periodically review employees' security profiles in all of its computer systems to ensure that access is limited to the profiles necessary for assigned job responsibilities.*

Prior Finding Not Resolved: The center did not adequately safeguard all receipts, separate incompatible duties in its receipt process, or reconcile recorded receipts to the deposit records.

Finding 3

The center did not have adequate internal controls over a significant portion of its receipt process. The center received about \$3.3 million from its arts high school and professional development and research during fiscal years 2004 through 2007. Of this amount, nearly \$1.6 million related to student fees.

We noted the following weaknesses in the center's receipt processes:

- The center did not open all mail centrally to ensure that it routed all receipts directly to the business office. The center inappropriately routed some unopened mail containing receipts to its divisions. The receipts lacked adequate safeguarding and accountability until division staff submitted them to the business office.
- In the arts high school, the center allowed teachers and staff to collect fees charged for prom, yearbooks, class rings, caps and gowns, and other high school-related activity. The center did not adequately safeguard or

³ SEMA4 Security Policy HR045: "Access should be granted to only those functions... necessary to perform their job duties. Incompatible access profiles are not permitted."

⁴ Department of Finance and Employee Relations Policy 1101-07.

account for these fees until the teacher or staff person submitted their collections to the business office.

- The center did not adequately separate incompatible duties. In several areas, staff involved in invoicing fees or maintaining account receivable records also collected the related receipts. For example, one person in the accounting office posted receipts to the subsystem, entered the receipts into the state's system, and made the bank deposit. In addition, the center's professional development and research staff sometimes registered individuals for seminars and collected the seminar fees.
- The center did not perform key reconciliations. Although the center kept a receipt log of the monies it collected, the center did not perform independent reconciliations between the log and bank deposit. The center also did not reconcile the state's accounting system to the center's stand-alone accounting subsystem. By not reconciling the two systems, the center cannot ensure that it properly recorded receipts.

These are fundamental weaknesses in internal controls. These weaknesses may have allowed errors or irregularities to occur without detection and provided an opportunity for manipulation of records and loss of funds. Finally, because the decentralized mail opening and receipt collection processes may have delayed the delivery of receipts to the business office, the center could not ensure compliance with statutory provisions that require it to deposit receipts daily.

Recommendations

- *From the time of initial receipt through the bank deposit, the center should:*
 - *establish effective internal controls to ensure a separation of incompatible duties and accountability for custody of the receipts; and*
 - *physically secure and safeguard receipts to protect them against loss or theft.*
- *The center should reconcile its accounting subsystem to financial activity recorded on the state's accounting system.*

Finding 4

The center did not notify law enforcement, the Office of the Legislative Auditor, or other agencies about thefts, as required by statutes.

The center did not notify the proper authorities about two thefts in August and October of 2007 totaling \$2,100. The center did not complete or submit a *Stolen, Lost, Damaged or Recovered Property Report* to the proper authorities, including

the Office of the Legislative Auditor, as required by statute and state policy.⁵ The center also failed to file a local police report when it did not find the property within five business days. In addition to being a statutory requirement, reports of stolen items allow our office to assess whether a serious internal control weakness exists, and whether the center has taken appropriate action to address the theft.

Recommendation

- *The center needs to complete and submit a Stolen, Lost, Damaged or Recovered Property Report to the appropriate authorities in compliance with applicable statutes and state policies.*

The center's internal controls were not adequate to ensure it accurately paid its employees.

Finding 5

The center had the following payroll weaknesses. Some weaknesses are related to its use of the state's online time reporting system – self service time entry. The self service time entry process automates employee timesheets and allows for electronic supervisory approval before uploading data into the state's payroll system for payment.

- The center did not review the *Self Service Time Entry Audit Report* to verify that employees accurately entered, and supervisors properly reviewed, hours worked or leave taken. This report, available for each pay period, identifies exceptions in the time reporting process. The report lists when someone other than the employee entered or modified the hours worked and when someone other than an employee's primary supervisor authorized the hours for payment. State policy requires the center to review the exceptions in the report and document the steps it took to verify the integrity of the reported hours and supervisors' authorizations.⁶
- The center did not establish an appropriate supervisory level review structure. It allowed six employees to approve their own time.
- The center's payroll for one pay period did not have management level authorization because the person who could provide that authorization had retired. The center had not designated a secondary approver for that key management position.

⁵ *Minnesota Statutes* 2007, 609.456, subd. 2, and Department of Administration FMR-1G-01 Property Management Guidelines.

⁶ Department of Finance Policy and Procedure PAY0017.

- The center's payroll clerk did not reduce an employee's vacation balance by 24 hours when correcting a coding error from a previous pay period.

Without reviewing the *Self Service Time Entry Audit Report*, the center cannot be assured that it appropriately reviewed and authorized payroll transactions. Further, without proper supervisory reviews, errors or fraud could occur and not be detected.

Recommendations

- *The center should review the Self Service Time Entry Audit Report each pay period to verify the accuracy and authorization of employee time records.*
- *The center should restructure its self service time entry authorizations to ensure that employees cannot authorize their own hours, and there is sufficient backup for key management level authorizations.*
- *The center should correct the employee's vacation leave records.*

Finding 6

The center's internal controls over travel and other reimbursements were not adequate to ensure the accuracy of the reimbursements.

The center did not ensure that travel and other expense reimbursement claims were properly authorized, supported by documentation, approved for payment, or paid in accordance with collective bargaining units or other applicable agreements.⁷ The center paid 13 of 18 expense reimbursement requests tested without sufficient or appropriate documentation to support the amount claimed. Most of the tested reimbursement requests covered weeks or months of travel-related activity, which increased the risk of errors. For the tested reimbursements, the center inappropriately paid nearly \$3,000 on the claims:

- The center reimbursed \$1,301 without appropriate or advance authorization.
- The center incorrectly reimbursed \$775 through business office errors – paying the same expense claim twice and incorrectly correcting a previous error.

⁷ In addition to employee reimbursements, the business office reimbursed travel costs of arts-related trainees who attended its professional development courses.

- The center reimbursed \$460 for lodging and meals that lacked original receipts⁸ or had receipts that did not support the claimed expense.
- The center reimbursed \$217 for excessive mileage. The center did not appropriately apply certain collective bargaining agreement rules about determining the amount of reimbursable mileage or paid for mileage that exceeded official mileage between travel points.
- The center reimbursed \$178 for meals to employees who were not eligible for reimbursement because they were not in travel status or because meals were provided as part of a conference.
- The center over-reimbursed \$34 and under-reimbursed \$5 by not reimbursing in accordance with limits and rates specified in the applicable collective bargaining agreements.

State and center policies⁹ require original receipts (for certain costs), adequate documentation, and authorization as a basis for an agency to reimburse claims.

Recommendations

- *The center should review all of its employees' expense reimbursements claims to determine if other overpayments occurred and, if so, pursue recovery.*
- *The center should develop procedures to ensure that it effectively reviews reimbursement claims before payment to ensure that claims are for allowable expenses in collective bargaining agreements and state regulations, properly authorized, supported by documentation, and approved for payment.*

The center did not sufficiently document compensation decisions for some new employees.

Finding 7

The center did not document the basis for determining some new employees' initial compensation or the approval for that compensation. The center hired ten new teachers and two new school nurses. Applicable bargaining agreements require the center to document the basis for the initial compensation rate and obtain the proper approval.

⁸ Although not required by state policy, the center required receipts for meals associated with certain programs.

⁹ SEMA4 Policy PAY 0021 and Perpich for the Arts Education Expense Reimbursement Policy (2-10-2006 Version)

Recommendation

- *The center needs to obtain proper authorization for initial compensation and document the basis for its compensation decisions in accordance with state personnel rules, personnel plans, and collective bargaining agreements.*

Finding 8**The center did not comply with applicable collective bargaining agreements for performance and achievement award increases.**

One employee did not receive an annual performance appraisal before receiving a salary increase, as required by the applicable bargaining agreement. According to the 2005-2007 Commissioner's Plan, the center could grant a salary increase of up to 3.5 percent to each employee based on performance standards or objectives. The center awarded this employee a performance increase without conducting a performance review. Timely performance appraisals provide assurance that the center is effectively managing its workforce and provides the opportunity for feedback to newly hired employees and employees who have assumed new roles and responsibilities within the center.

In addition, the center awarded too many achievement awards to employees covered by the Middle Management Association bargaining agreement. The center gave three employees achievement awards in fiscal year 2007 when the bargaining agreement only allowed two.

Recommendations

- *The center should ensure that supervisors complete timely employee performance evaluations in compliance with applicable requirements.*
- *The center should ensure that it awards achievement increases in compliance with applicable bargaining units/plans.*

Finding 9**The center did not establish sufficient internal controls or comply with legal requirements for the procurement of goods and services.**

The center did not have adequate internal controls to ensure compliance with statutes, policies, and procedures over purchase requests, encumbrance of funds, prompt payments, and special expense authorizations. The center is required to follow the state's policies and procedures for purchasing goods and services, and it uses the state's accounting and procurement system to process its transactions.

Testing of 61 transactions involving payments to 19 vendors identified the following weaknesses in the center's procurement process:

- The center did not always ensure that transactions it paid agreed with supporting documentation. The center processed one transaction where the receiving documentation did not agree with the purchase order, resulting in an overpayment of \$80. An additional two payments were made for an incorrect amount based on original approval.
- Five items did not have a signed purchase request form, and two change purchase orders were not authorized by an employee with the proper delegated authority, as required by the Department of Administration.¹⁰
- The center did not create seven purchase orders until after it ordered the goods or services. As a result, the center had not encumbered funds for these purchases in advance of incurring an obligation, as required by state statutes¹¹ and policies.¹² Agencies encumber funds as part of the process to create purchase orders.
- The center did not promptly pay three vendors because the center temporarily lost the invoices. The transaction payments ranged from \$250 to \$750, and the delays ranged from one to eight months. State statutes¹³ and policies¹⁴ require that agencies make payments to vendors within 30 days.
- The center paid \$311 for 60 catered box lunches without obtaining authorization for this "special expense." In addition, the center paid nearly \$1,500 more than authorized for three invoices associated with conferences. The center had authorized an initial amount of "special expense" for the lodging and meals associated with the conferences, but did not seek additional authorization when costs increased. Costs sometimes increased due to a need to provide meals for unexpected conference attendees. Special expenses are generally refreshments, meals, and lodging which cannot be otherwise reimbursed. For example, special expenses include meals and lodging for employees who are not in travel

¹⁰ Department of Administration, Materials Management, Policies 0703-00, Purchasing Goods and Services Section Overview, and 0703-02, Authority for Local Purchase.

¹¹ *Minnesota Statutes* 2007, 16A.15, subd. 3 and 16C.

¹² Department of Finance and Employee Relations, Agency Assistance Policy 0702-02, Obligations Incurred Before Funds Were Properly Encumbered/Budgeted.

¹³ *Minnesota Statutes* 2007, 16A.124.

¹⁴ Department of Finance and Employee Relations, Systems Compliance Policy 0701-01, Prompt Payment Processing, and Department of Administration, Materials Management Policy 0803-01, Payment Requests, Preparation and Approval.

status. The state's special expense policy¹⁵ requires advance authorization of these expenses to ensure that planned expenses are reasonable and necessary.

Recommendation

- *The center should ensure that it purchases goods and services in compliance with applicable statutes and state policies.*

Finding 10

The center did not properly administer its professional/technical service contracts.

The center did not properly initiate, execute, monitor, or pay its professional/technical services contracts. Contracts for professional/technical services are for services that are intellectual in nature and include consultation, analysis, evaluation, prediction, planning, programming, or recommendation and result in the production of a report or completion of a task. The 18 contracts tested totaled approximately \$95,000. The center did not follow the policies and procedures established by the Department of Administration.¹⁶ The center had the following weaknesses found in testing of 18 professional/technical services contracts:

- The center did not use the correct contract form in nine instances.
- The center did not have adequate supporting documentation for 11 contracts.
- The center allowed work to begin on 12 contracts before the contracts were fully executed.
- The center did not obtain the Department of Administration's authorization on four contracts.
- The center did not encumber the entire amount of five contracts.
- The center did not verify if vendors were suspended or debarred for any of the 18 contracts.
- The center did not prepare solicitations and provide public notice for two contracts.
- The center did not certify the unavailability of state employees to perform needed services related to four contracts.
- The center did not outline evaluation criteria and rank proposals in accordance with established evaluation criteria for four contracts.

¹⁵ Department of Finance and Employee Relations Administrative Procedure 4.4, Special Expenses.

¹⁶ Department of Administration Policies and Procedures for Professional/Technical Service Contracts (<http://www.mmd.admin.state.mn.us/mn05001.htm>).

- The center did not complete the statutorily required performance evaluation reports for the three contracts that exceeded \$50,000.¹⁷
- The center did not include a retainage clause or abide by statutory retainage requirements for five contracts.¹⁸
- The center did not properly execute three contracts for services received.
- The center used an incorrect contract number in the accounting system for one contract.

The center was not complying with contracting laws and regulations when it deviated from the policies and procedures established by the commissioner of Administration for the supervision, control, and review of all state contracts.

Recommendation

- *The center should comply with all requirements established by statute and the Department of Administration for professional/technical service contracts.*

The center improperly established a credit relationship with an online vendor in violation of state regulations.

Finding 11

The center used an on-line vendor to purchase goods in violation of *Minnesota Statutes*.¹⁹ The center agreed to terms and conditions for purchases made on account from a large online vendor. The center purchased the goods on-line and was billed monthly by the vendor. The center spent approximately \$17,000 with the vendor. The invoices contained the terms and conditions of the credit arrangement. The Department of Administration requires agencies to obtain prior written approval before entering into credit agreements that have terms and conditions.

Recommendation

- *The center should not enter into a credit relationship and agree to terms or conditions for purchases without proper authorization.*

¹⁷ *Minnesota Statutes* 2007, 16C.08, subd. 4 (c).

¹⁸ *Minnesota Statutes* 2007, 16C.08, subd. 5 (b).

¹⁹ *Minnesota Statutes* 2007, 16C.05.

Finding 12

The center did not properly record the liability date for some expenditure transactions in the state's accounting system.

The center did not always record the date the state incurred a liability for its expenditure transactions. The center recorded an incorrect record date in the state's accounting system for 10 of the 61 purchase orders tested. For these items, the recorded date was inconsistent with documentation supporting the transaction. The Department of Finance and Employee Relations requires agencies to record the transaction's liability date to indicate when goods or services are received and to determine in which period the accounting system should recognize transactions. If the agency records an incorrect liability date, the transactions may accrue to the wrong fiscal year and cause a misstatement in financial statements.

Recommendation

- *The center should code the correct liability date in the state's accounting system when processing payments.*

Finding 13

The center did not accurately record certain expenditures in the state's accounting systems.

The center used the state's accounting system to purchase goods and services, pay vendors, record accounting transactions, and prepare financial reports. However, testing of a sample of transactions identified that the center incorrectly coded the following transactions in the state's accounting systems:

- Lodging costs of \$124 incorrectly coded as meals;
- Taxable meals of \$24, incorrectly coded as not taxable lodging;
- Nontaxable meals of \$24 incorrectly coded as taxable;
- Taxable meals of \$25 incorrectly coded as nontaxable.
- A \$575 training/tuition activity incorrectly coded as conference registration;
- A \$3,960 contract for transportation services incorrectly coded as a professional/technical contract; and
- One student scholarship and two student class rings incorrectly coded as supplies.

Some of the errors noted above resulted in the center inaccurately reporting taxable compensation to its employees and the state and federal governments.

In addition, the center coded numerous transactions to the generic object code "Other Purchased Services." The center's wide use of this object code made it difficult to readily identify the true nature of the expenditure without reviewing

supporting documentation. The center is responsible for the proper recording of its transactions in the state's accounting systems. Earnings and object codes should accurately reflect the nature of the expenditure.

Recommendations

- *The center should ensure that it correctly codes all financial activity in the state's accounting systems.*
- *The center should determine the extent of federal and state income tax errors as a result from coding errors and resolve any over or under reporting of employees' taxable income.*

The center did not monitor personal use of state-owned cell phones, as required by state policy and federal Internal Revenue Service regulations.

Finding 14

The center did not require employees to review monthly cell phone bills to identify personal calls. In addition, the center could not provide evidence that employees with state-owned cell phones had received and reviewed state policies over cell phones before the issuance of the cell phones. State policy requires that employees acknowledge in writing the receipt and acceptance of the conditions for the individual assignment of a state-owned cell phone before the issuance of the cell phone.²⁰ The center had four cell phones as of December 2007 and spent a total of approximately \$5,200 during fiscal years 2004 through 2007.

State policy also requires employees who receive state-issued cell phones to review and identify all personal calls, including essential calls and nonessential calls, and submit the information for supervisory review and approval each month. The policy defines essential calls as being of minimal duration and frequency, urgent in nature, and unable to be made at another time from a different phone; all other personal calls are considered nonessential. Any nonessential personal calls must be reimbursed to the state within 30 days. The intent of the policy is to ensure compliance with federal Internal Revenue Service (IRS) regulations for employers who issue cell phones to employees. According to current IRS rules, unless employers enforce a policy that employees track personal cell phone use and require employee reimbursement of the personal calls, including a prorated share of the monthly service fee, employers must report the total cell phone expense as income to the employee.

By not requiring employees to review monthly statements for personal calls, in addition to not complying with state and IRS regulations, the center may pay unallowable personal cell phone expenses. In addition, by not tracking personal calls, the center may not be able to determine whether the extent of business use

²⁰ Department of Administration Statewide Policy: Appropriate Use of Electronic Communication and Technology.

justifies the cost of the cell phone during its annual cost benefit analysis of cell phones issued to individual employees.

Recommendations

- *The center should obtain and retain written acknowledgements from employees who have received a state-owned cell phone that they understand state policies governing cell phone use.*
- *The center should monitor the personal use of state-owned cell phones by employees and require reimbursement for nonessential personal calls, including a pro-rated share of the monthly service plan.*

Finding 15

The center did not ensure that employees complied with statutes that prohibit personal benefit from state travel expenditures.

Two employees did not comply with legal provisions that prohibit employees from deriving certain benefits from state employment. *Minnesota Statutes*²¹ require that whenever public funds are used to pay for airline travel by a public employee, any credits or other benefits issued by any airline must accrue to the benefit of the public body providing the funding. The statute also requires that employees report the benefit to the agency paying for the travel within 90 days of receipt of the benefit. Both employees were unaware of the statutory requirements. In addition, the center allowed one employee, who received airline travel credits as discussed above, to also accrue hotel rewards while conducting state business. *Minnesota Statutes*²² prohibit state employees from receiving any compensation, reward, or future benefit from any source except from the state for any activity related to the duties of the employee while on state business.

Recommendations

- *The center should ensure that employees are aware of all legal provisions related to state employment.*
- *The center should monitor employees' business expense reimbursements to ensure compliance with statutes that prohibit personal benefit from state paid travel expenditures.*

²¹ *Minnesota Statutes* 2007, 15.435.

²² *Minnesota Statutes* 2007, 43A.38, subd. 2.

The center did not adequately monitor the relationship with its foundation.**Finding 16**

The center did not monitor the activity of its foundation to ensure compliance with the terms and conditions of a contract established in 2004. The center entered into a contract with its foundation that stipulated the center would perform administrative support and oversight. The contract required the foundation to maintain its charitable status, file annual financial statements, prepare required reports, obtain external audits, and ensure that its contributions to the center met or exceeded the costs incurred by the center on behalf of the foundation. However, the center did not review the foundation's activity or obtain the required financial statements and other reports. As of December 2007, the foundation had annual receipts ranging from \$81,000 and \$120,000. In addition, the center and the foundation did not renew their contract when the original agreement expired in January 2007.

Recommendations

- *The center should monitor the activity of its foundation to ensure that terms and conditions agreed upon in writing have occurred.*
- *The center should have a written contract with its foundation to establish each party's rights and responsibilities.*

Prior Finding Not Resolved: The center did not have a record retention policy, as required by Minnesota Statutes.**Finding 17**

*Minnesota Statutes*²³ require that the head of each state agency establish and maintain an active, continuing program for the economical and efficient management of records. The state instructs agencies to prepare an inclusive inventory of records in their custody and attach a schedule, approved by the head of the agency, establishing a time period for the retention or disposal of each series of records. By neglecting to have a record retention policy, the center is not complying with state law and risks not having the necessary documentation to support its transactions and safeguard its employee and student records.

Recommendation

- *The center should comply with Minnesota Statutes and develop a comprehensive record retention policy with applicable schedules.*

²³ *Minnesota Statutes* 2007, 138.17, subd. 7.



October 1, 2008

James R. Nobles, Legislative Auditor
Office of the Legislative Auditor, Rm 140
658 Cedar Street
St Paul, Minnesota 55155-1603

Dear Mr. Noble:

This is a formal response to your office's draft report of audit results for our agency during the period July 1, 2003 through July 30, 2007.

We acknowledge and agree with all aspects of the audit and recognize our responsibility to significantly improve administrative operations. In this regard, the Center has been addressing areas relating to audit findings in the Report from the time of the Legislative Audit fieldwork, which ended in April 30th, 2008. The agency established and filled, in July, 2008, a new position for Director of Administrative Management to improve internal controls and compliance with finance-related legal requirements.

From July through September 2008, the Center addressed and made significant progress for all areas relating to audit findings, establishing internal control procedures for over 50% of the specific areas cited in them.

Recommendations and Agency response for each finding follow:

Finding 1:

The center did not adequately fulfill its financial management responsibilities to control certain activities and ensure that it complied with state and center policies.

Audit Recommendations:

- The center needs to review its financial operations and implement controls to ensure transactions are accurate, properly approved, documented, and in compliance with state and agency policies.

Agency Response:

The Center agrees with the recommendations, and has undertaken initial assessments on the areas listed in this report Findings 2 through 17 as stated below. The agency will consult with the Minnesota Department of Finance, The Minnesota Department of Administration, and the Department of Employee Relations to ensure that appropriate controls, and proper policy related to those controls, are implemented. Since the Legislative Audit fieldwork, the Center has created new policies and modified its systems for better internal controls. The agency recognizes that this is an ongoing process, and will rigorously strive to continuously improve internal control.

Finding 2:

Prior Finding Not Resolved: The center did not adequately control access to the states or center's computerized business systems.

Audit Recommendations:

- The center should eliminate incompatible employee access to the computer systems or develop, document, and monitor mitigating controls that provide independent scrutiny and review of the activity processed by those employees.
- The center should remove all access to its computer systems when employees leave employment.
- The center should periodically review employees' security profiles in all of its computer systems to ensure that access is limited to the profiles necessary for assigned job responsibilities.

Agency Response:

The Center agrees with the recommendations and has already limited access to the computer security system. The agency has made the necessary changes in the SEMA4 system to remove access by unauthorized personal, and any possibility of access by former employees. The Center is additionally reviewing employees' security profiles on bi-monthly bases in order to make necessary changes. The agency will consult with Minnesota Department of Employee Relations, and the Minnesota Department of Finance to ensure proper compliance and clarity in creating an internal policy for this area.

Responsible Parties:

Valerie Osborn, Deb Ambright, Nedra Fitzloff-Meyer

Estimated Completion Date for all components:

March 2009

Finding 3:

Prior Finding Not Resolved: The center did not adequately safeguard all receipts, separate incompatible duties in its receipt process, or reconcile recorded receipts to the deposit records.

Audit Recommendations:

- From the time of initial receipt through the bank deposit, the center should:
 - establish effective internal controls to ensure a separation of incompatible duties and accountability for custody of the receipts; and
 - physically secure and safeguard receipts to protect them against loss or theft.
- The center should reconcile its accounting subsystem to financial activity recorded on the state's accounting system.

Agency Response:

The Center agrees with the recommendations and is making major changes to improve tracking of receipts from reception to deposit. The agency now centralizes its mail process so that all mail is opened in one location. Additionally, the receipt log technology function no longer permits editing; receipts from performances, events or high school student payments for arts high school related activities, are now centrally collected and logged. Our Human Resource Office has modified the SEMA 4 system to ensure that only properly approved employees can make payroll revisions. The agency will consult with Minnesota Department of Employee Relations, and the Minnesota Department of Finance to ensure proper compliance and clarity in creating an internal policy for this area.

Responsible Parties:

Nedra Fitzloff-Meyer, Valerie Osborn, Deb Ambright, John Engel

Estimated Completion Date for all components:

February 2009

Finding 4:

The center did not notify law enforcement, the Office of the Legislative Auditor, or other agencies about thefts, as required by statutes.

Audit Recommendations:

- The center needs to complete and submit a Stolen, Lost, Damaged or Recovered Property Report to the appropriate authorities in compliance with applicable statutes and state policies.

Agency Response:

The agency agrees with the recommendation and is in process of filing the Stolen, Lost, Damaged or Recovered Property Report to the appropriate authorities. The agency will consult with Minnesota Department Administration and the Department of Finance to ensure proper compliance and clarity in creating an internal policy for this area.

Completion Date:

October 2008

Responsible Parties:

Nedra Fitzloff-Meyer, Bill Nash, Valerie Osborn, Deb Ambright

Finding 5:

The center's internal controls were not adequate to ensure it accurately paid its employees.

Audit Recommendations:

- The center should review the Self Service Time Entry Audit Report each pay period to verify the accuracy and authorization of employee time records.
- The center should restructure its self service time entry authorizations to ensure that employees cannot authorize their own hours, and there is sufficient backup for key management level authorizations.
- The center should correct the employee's vacation leave records.

Agency Response:

The Center agrees with the recommendations and has modified authorizations for this process to prevent individuals from approving their own time entry. Agency procedure will now only permit managers, or back up managers, to approve time entries of employees. A review of the Self Service Time Entry Audit Report will be completed for every pay period. The agency will consult with Minnesota Department of Employee Relations, and the Minnesota Department of Finance to ensure proper compliance and clarity in creating an internal policy for this area.

Completed Date:

September 2008

Responsible Parties:

Nedra Fitzloff-Meyer, Valerie Osborn, Deb Ambright

Finding 6:

The center's internal controls over travel and other reimbursements were not adequate to ensure the accuracy of the reimbursements.

Audit Recommendations:

- The center should review all of its employee's expense reimbursements claims to determine if other overpayments occurred and, if so, pursue recovery of funds.
- The center should develop procedures to ensure that there is effective review of reimbursement claims before payment is made to ensure that claims are for allowable expenses in collective bargaining agreement and state regulations, properly authorized, supported by documentation, and approved for payment.

Agency Response:

The Center agrees with the recommendations and has developed a system to ensure that all travel and expense reimbursements claims are screened for accuracy, with attached original receipts along with the proper approvals. The agency will work to ensure that reimbursements are made based on appropriate Minnesota state statute, policy and bargaining agreement requirements. The Center's Director of Administrative Management will review previous expense reimbursement claims to determine if there has been overpayment and will pursue fund recovery if appropriate. The agency will consult with the Minnesota Department of Employee Relations, Minnesota Department of Finance and the Minnesota Department of Administration to ensure proper compliance and clarity in creating an internal policy for this area.

Estimated Completion Date for all components:

April 2009

Responsible Parties:

Nedra Fitzloff-Meyer, Valerie Osborn, Deb Ambright

Finding 7:

The center did not sufficiently document compensation decision for some new employees.

Audit Recommendations:

- The center needs to obtain proper authorization for initial compensation and document the basis for its compensation decisions in accordance with state personnel rules, personnel plans, and collective bargaining agreements.

Agency Response:

The Center agrees with the recommendation and has been in compliance for this finding since October 31, 2007 - with the appointment of an experienced full-time Human Resources staff member. All appointments since October 31, 2007 have been documented and approved by obtaining proper authorization for initial compensation, and documenting the basis for its decisions in accordance with state personnel rules, personnel plans and collective bargaining agreements. The agency will consult with Minnesota Department of Employee Relations, Minnesota Department of Finance to ensure proper compliance and clarity in creating an internal policy for this area.

Estimated Completion Date for all components:

February 2009

Responsible Parties:

Nedra Fitzloff-Meyer, Valerie Osborn

Finding 8:

The center did not comply with applicable collective bargaining agreement for performance and achievement award increases

Audit Recommendations:

- The center should ensure that supervisors complete timely employee performance evaluation in compliance with applicable requirements.
- The center should ensure that it awards achievement increases in compliance with applicable bargaining units/plans.

Agency Response:

The Center agrees with the recommendations and has been in compliance since October 31, 2007 - with the appointment of an experienced Human Resources staff member. All files for employees who received achievement awards will be reviewed for accuracy and adjustment; funds will be collected if necessary. The agency will consult with the Minnesota Department of Employee Relations, and the Minnesota Department of Finance to ensure proper compliance and clarity in creating an internal policy for this area.

Estimated Completion Date for all components:

February 2009

Responsible Parties:

Nedra Fitzloff-Meyer, Valerie Osborn

Finding 9:

The center did not establish sufficient internal controls or comply with legal requirements for procurement of goods and services.

Audit Recommendations:

- The center should ensure that it purchases goods and services in compliance with applicable statutes and state policies.

Agency Response:

The Center agrees with the recommendation and has now established a system in which the account clerk screens purchase orders ensuring that they have supporting documentation, special request forms, and a delegated authority signature prior to purchase. Purchases will not occur prior to completion of a purchase order. The agency will consult with the Minnesota Department of Finance and the Minnesota Department of Administration to ensure proper compliance and clarity in creating an internal policy for this area.

Estimated Completion Date for all components:

February 2009

Responsible Parties:

Nedra Fitzloff-Meyer, Deb Ambright

Finding 10:

The center did not properly administer its professional/technical services contracts.

Audit Recommendations:

The center should comply with all requirements established by statute and the Department of Administration for professional/technical service contracts.

Agency Response:

The Center agrees with the recommendation. In July 2008, the Center hired a new Administrative Management Director to coordinate administrative services. Under the leadership of this position, the Center will centralize contract services to ensure compliance. The agency will consult with the Minnesota Department of Finance and the Minnesota Department of Administration to ensure proper compliance and clarity in creating an internal policy for this area.

Estimated Completion Date:

May 2009

Responsible Parties:

Nedra Fitzloff-Meyer, Deb Ambright, Jennifer Manning

Finding 11:

The center improperly established a credit relationship with an online vendor in violation of state regulations.

Audit Recommendations:

- The center should not enter into a credit relationship and agree to terms or conditions for purchases without prior authorization.

Agency Response:

The Center agrees with the recommendation and has ended the credit relationship cited in the audit for fiscal year 2009, and will not establish any further credit relationships without prior authorization. The agency will consult with the Minnesota Department of Finance and the Minnesota Department of Administration to ensure proper compliance and clarity in creating an internal policy for this area.

Estimated Completion Date for all components:

October 2008

Responsible Parties:

Nedra Fitzloff-Meyer, Deb Ambright

Finding 12:

The center did not properly record the liability date for some expenditures transactions in the state's accounting system.

Audit Recommendations:

- The center should code the correct liability date in the state's accounting system when processing payments.

Agency Response:

The Center agrees with the recommendation and now operates with a system in which the account clerk carefully screens data to ensure that the liability date is coded correctly. The agency will consult with the Minnesota Department of Finance and the Minnesota Department of Administration to ensure proper compliance and clarity in creating an internal policy for this area.

Estimated Completion Date for all components:

October 2008

Responsible Parties:

Nedra Fitzloff-Meyer, Deb Ambright

Finding 13:

The center did not accurately record certain expenditures in the state's accounting system.

Audit Recommendations:

- The center should ensure that it correctly codes all financial activity in the state's accounting systems.
- The center should determine the extent of federal and state income tax errors as a result from coding error and resolve any over and under reporting of employees' taxable income.

Agency Response:

The Center agrees with the recommendations and now operates with a system in which the account clerk carefully screens data to ensure that the expenditures are coded correctly. Center staff will also screen prior transactions to determine the extent of federal and state income tax errors. The agency will consult with the Minnesota Department of Finance and the Minnesota Department of Administration to ensure proper compliance and clarity in creating an internal policy for this area.

Estimated Completion Date:

May 2009

Responsible Parties:

Nedra Fitzloff-Meyer, Deb Ambright

Finding 14:

The center did not monitor personal use of state-owned cell phones, as required by state policy and federal Internal Revenue Service regulations.

Audit Recommendations:

- The center should obtain and retain written acknowledgements from employees who have received a state-owned cell phone that they understand state policies governing cell phone use.
- The center should monitor the personal use of state-owned cell phones by employees and require reimbursement for nonessential business use.

Agency Response:

The agency agrees with the recommendation. A system is now in place where all cell phone bills are reviewed by the user, and then signed and dated, with documentation of all non-state use. Reimbursement is required for all accrued minutes of

non-state use. The agency will consult with the Minnesota Department of Finance and the Minnesota Department of Administration to ensure proper compliance and clarity in creating an internal policy for this area.

Estimated Completion Date for all components:

October 2008

Responsible Parties:

Nedra Fitzloff-Meyer

Finding 16:

The center did not adequately monitor the relationship with its foundation.

Audit Recommendations:

- The center should monitor the activity of its foundation to ensure that terms and conditions agreed upon in writing have occurred.
- The center should have a written contact with its foundation to establish each party's rights and responsibilities.

Agency Response:

The Center agrees with the recommendations. The agency has established a new agreement with the Perpich Center for Arts Education Foundation, and will adhere to its stated stipulations.

Estimated Completion Date:

October 2008

Responsible Parties:

Nedra Fitzloff-Meyer

Finding 17:

The center did not have a record retention policy, as required by Minnesota Statutes

Audit Recommendations:

- The center should comply with Minnesota Statutes and develop a comprehensive record retention policy with applicable schedules.

Agency Response:

The Center agrees with the recommendation and will establish a committee to develop a state record retention and schedule system -- based on Policy and Procedure and state statute for state record retention. The agency will consult with the Minnesota Department of Administration and state statute to ensure proper compliance and clarity in creating an internal policy for this area.

Estimated Completion Date for all components:

May 2009

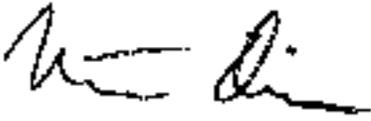
Responsible Parties:

Nedra Fitzloff-Meyer, Deb Ambright, Valerie Osborn, Alice Woog

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Thank you for your attention to our agency's audit response. The Center has acted swiftly to tighten internal controls. Please be assured that the Perpich Center for Arts Education is dedicated to fully meeting the accountability thresholds, requirements and expectations of your office.

Sincerely,

A handwritten signature in black ink, appearing to read "Nathan Davis". The signature is fluid and cursive, with a prominent initial "N" and "D".

Nathan Davis
Executive Director
Perpich Center for Arts Education