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OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Financial Audit Division Report

Minnesota Technology, Inc.

SEPTEMBER 17, 2004 **04-38**

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.

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Representative Tim Wilkin, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Dr. Wayne A. Pletcher, President and CEO
Minnesota Technology, Inc.

We have audited selected areas of Minnesota Technology, Inc. (MTI) for the period July 1, 2000, through June 30, 2003. Our audit scope was limited to payroll, grants, and other administrative expenditures. The Report Summary highlights our overall audit conclusions. The specific audit objectives and conclusions are contained in the individual chapters of this report.

We selected MTI for audit based on our 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.

We conducted our audit in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we obtain an understanding of MTI's internal controls relevant to the audit objectives. We used the guidance contained in *Internal Control-Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission, as our criteria to evaluate agency controls.

The standards also require that we plan the audit to provide reasonable assurance that MTI complied with financial-related legal provisions that are significant to the audit. In determining the company'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 MTI's financial policies and procedures. We considered the risk of misstatements 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 a sample of evidence supporting the agency's internal controls and compliance with laws, regulations, contracts, and grant provisions.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: June 4, 2004

Report Signed On: September 13, 2004

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Audit Participation

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

Claudia Gudvangen, CPA	Deputy Legislative Auditor
Thomas Donahue, CPA	Audit Manager
Joan Haskin, CPA, CISA	Auditor-in-Charge
Carl Otto, CPA CISA	Auditor

Exit Conference

We discussed the results of the audit with the following staff of Minnesota Technology, Inc. at an exit conference on August 30, 2004:

Dr. Wayne Pletcher	President and CEO
Pat Vasatka	Controller/Director of Finance

Report Summary

Key Findings:

- MTI did not maintain adequate supporting documentation for some administrative expenditures. (Finding 2, page 9)
- MTI did not comply with its purchasing policy regarding some purchase orders. (Finding 3, page 9)

Other Conclusions:

- MTI's internal controls provided reasonable assurance that expenditures were properly authorized and recorded in the accounting system.

The audit report contained 3 audit findings relating to internal control or legal compliance. There were no findings in our prior audit report.

Audit Scope:

Audit Period:
Fiscal Years 2001-2003

Selected Audit Areas:
- Payroll
- Grant expenditures
- Other administrative expenditures

Agency Background:

MTI is a public, nonprofit corporation established to assist Minnesota companies to become more competitive through the application and development of technology. MTI operates under the provisions of Minn. Stat. Chapter 1160. MTI receives direction from a 7-member board. Fiscal year 2003 expenditures totaled $7,852,368. The Legislature appropriated $3 million in transition funding for fiscal year 2004, but did not provide base funding for any future year.

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Chapter 1. Introduction

Minnesota Technology, Incorporated (MTI) is a public, nonprofit corporation established to assist Minnesota companies in becoming more competitive through the application and development of technology. MTI operates ten offices throughout the state. The main office is located in Minneapolis with other offices in Alexandria, Bemidji, Duluth, Hutchinson, Moorhead, Owatonna, Rochester, St. Cloud, and Virginia.

MTI operates under the provisions of Minn. Stat. Chapter 1160. Its purpose, as specified in Section 1160.03, is:

> ...to foster long-term economic growth and job creation by stimulating innovation and the development of new products, services, and production processes through energy conservation, technology transfer, applied research, and financial assistance. The primary focus of the corporation's activities must be to benefit new or existing small and medium-sized businesses in greater Minnesota.

MTI receives direction from a 7-member board. The board is responsible for appointing a president who serves as the chief executive officer of the corporation. Jacques Koppel served as MTI's president through July 2003. In December 2003, the board appointed Dr. Wayne A. Pletcher as president and CEO. Although MTI is not subject to the laws governing a state agency, it must follow certain financial reporting, budgeting, allotting, encumbering, accounting, and indirect cost requirements specified in Minn. Stat. Section 16A.

A public accounting firm annually audits the financial statements of MTI. Table 1-1 shows summarized information from MTI's Balance Sheet as of June 30, 2003.

Table 1-1
Balance Sheet
As of June 30, 2003

Assets	
Cash and cash equivalents	$1,955,193
Accounts receivable	186,846
Due from federal government	501,064
Interest receivable	2,574
Equipment and leasehold improvements (net of depreciation)	183,651
Total Assets	$2,829,328
Liabilities:	
Accounts payable	$ 84,896
Accrued expenses	457,676
Total Liabilities	$542,572
Net Assets:	
Unrestricted	$2,103,105
Invested in capital assets	183,651
Total Net Assets	$2,286,756
Total Liabilities and Net Assets	$2,829,328

Note: MTI received a qualified opinion on its fiscal year 2003 financial statements.

Source: MTI's audited financial statements as of June 30, 2003.

MTI operations are financed primarily through General Fund appropriations and federal grants. Appropriations to MTI were $6,305,000, $5,005,000, and $5,358,360 for fiscal years 2001, 2002, and 2003, respectively. MTI appropriations were reduced through transfers back to the state of $900,000 and $1,071,000 for fiscal years 2002 and 2003, respectively. MTI also received appropriations of $1,120,000 and $925,000 for fiscal years 2001 and 2002, respectively, that were pass-through grants to several outside organizations as identified in Table 4-1. The Legislature appropriated $3 million in transition funding for fiscal year 2004, but did not provide base funding for any future year.

Chapter 2. Payroll

Chapter Conclusions

MTI's internal controls provided reasonable assurance that payroll expenditures were appropriate and in compliance with board policies and applicable legal provisions. However, MTI had an inadequate separation of duties over payroll processing in 2004.

For the items tested, MTI complied, in all material respects, with significant finance-related legal provisions concerning payroll.

Audit Objectives

Our audit of MTI's payroll expenditures focused on the following questions:

- Did MTI's internal controls provide reasonable assurance that payroll expenditures were appropriate and in compliance with board policies and applicable legal provisions?
- For the items tested, did MTI comply, in all material respects, with significant finance-related legal provisions concerning payroll?

Background

MTI currently employs approximately 30 full-time employees. MTI significantly reduced personnel from 90 to 30 towards the end of fiscal year 2003 due to state funding cuts. MTI made severance payments to the terminated employees. MTI employees are not state employees, but Minn. Stat. Section 1160.04, Subd. 2, provides that they may participate in the state's retirement system, insurance plans, and deferred compensation program. MTI employees serve at the pleasure of the corporation, similar to unclassified positions in state service. Unlike the state's classified service, employee bargaining units do not represent MTI employees.

MTI has an employee manual that details employee classification, attendance, benefits, and termination policies. Benefits include sick leave, vacation leave, personal leaves of absence, family and medical leave, and severance pay. MTI employees submit their timesheets on a biweekly basis and are paid every other Friday. MTI's full-time salary expenditures totaled $5,877,496, $6,162,411, and $5,317,324 for fiscal years 2001, 2002, and 2003, respectively.

MTI has contracted with a private vendor to process employee payroll checks, provide reports, and file various wage detail reports. Most employees have requested direct deposit of their payroll. MTI maintains a clearing account for its employee payroll at a local bank.

Finding and Recommendation

1. MTI did not maintain an adequate separation of duties over the payroll process in 2004.

In January 2004, MTI hired a temporary contract controller. This employee entered payroll information such as hours and pay rates into the accounting system. In addition, this employee also entered new employees into the system and subsequently reconciled the payroll bank account. No one independent of the payroll function reviewed this data. There should be an adequate separation of duties to ensure that personnel and payroll transactions are proper and in accordance with management's authorization. Without appropriate controls, errors or irregularities could occur and go undetected.

Recommendation

- *MTI should improve controls over payroll by adequately separating input and monitoring of payroll data.*

Chapter 3. Administrative Expenditures

Chapter Conclusions

MTI's internal controls provided reasonable assurance that its administrative expenditures were properly approved, accurately recorded in the accounting system, and in compliance with board policies and applicable finance-related legal provisions. However, MTI did not maintain adequate supporting documentation for some expenditure transactions. In addition, MTI did not consistently comply with its purchasing policy regarding some of its purchase orders. MTI maintained adequate control over its equipment inventory.

Except for the issues discussed in Findings 2 and 3, MTI complied with board policies, applicable finance-related legal provisions, and management authorizations for the items tested.

Audit Objectives

Our audit of MTI's administrative expenditures focused on the following questions:

- Did MTI's internal controls provide reasonable assurance that its administrative expenditures were properly approved, supported, and recorded in the accounting system and in compliance with board policies and applicable finance-related legal provisions?
- Did MTI maintain adequate control over equipment inventory?
- For the items tested, did MTI comply with board policies and applicable finance-related legal provisions and management authorizations?

Background

Administrative expenditures included payments for nonpayroll items, such as professional/technical services, purchased services, rent, printing and advertising, communications, and equipment. Table 3-1 summarizes selected administrative expenditures during the audit period, as recorded on a budgetary basis.

Table 3-1
Selected Administrative Expenditures
For the Three Years Ending June 30, 2003

	FY 2001	FY 2002	FY 2003
Professional/Technical Services	$764,038	$542,783	$830,095
Purchased Services	451,114	296,208	134,570
Printing and Advertising	361,003	278,556	170,445
Rent	436,461	449,823	339,151
Communications	265,718	264,496	242,376
Equipment	105,344	35,571	109,884

Source: Minnesota Accounting and Procurement System (MAPS) as of September 2003.

MTI's purchasing policy applies to the purchase of most goods and services and discusses competitive bidding, vendor selection, signature authority, purchase order processing, ordering, and invoicing. All noncontracted goods and services of $200 or more require the use of a purchase order. Contracted goods and services, including rent and utilities, do not require a purchase order. Approval for these transactions is evidenced in contract or other written form. Purchases must be properly authorized. The current policy establishes the following authorization limits. All purchases of $25,000 or more require board approval. The president approves purchases of $10,000 or more for noncontracted goods and services. The president also approves all contracts for general operating goods and services. The controller and department directors approve purchases of $200 to $9,999 for noncontracted goods and services.

In addition, MTI's policy provided the following directives for competitive bidding of goods and services:

- Goods/services less than $3,000 require no bids or quotes.
- Goods/services between $3,000 and $10,000 require at least three competitive bids.
- Goods/services over $10,000 require a minimum of three written bids.

In cases where goods or services can only be provided by one vendor, the president, the managing director, the director, or the controller must be consulted prior to making a commitment. In addition, a letter of justification to document the reasons for a sole source vendor is required.

During the audit period, MTI purchased general office equipment, including computers totaling $250,798. MTI maintained an electronic inventory file for its equipment and completed a physical inventory in January 2004.

Findings and Recommendations

2. MTI did not maintain adequate supporting documentation for some administrative expenditure transactions.

MTI did not maintain bid documentation for 11 of 13 sample items that required bids. The total cost of these 13 items was $126,807. MTI policy requires at least three competitive bids for goods/services between $3,000 and $10,000. The policy also requires a minimum of three written bids for goods/services over $10,000.

MTI did not maintain documentation to support its selection of six sole source vendors, with total expenditures of $64,051. MTI purchasing policies require the requisitioner to prepare a justification letter documenting the reason sole sourcing is required. The lack of competitive bidding may result in overpayment for services or a lower quality of service. Without bid documentation and justification letters, we were unable to determine if MTI complied with its purchasing policies and procedures.

In addition, there was no evidence of receipt of goods for five of seven equipment sample items tested. Staff should sign the packing slip or invoice to indicate that goods have been received. Incomplete documentation increases the risk that MTI could pay for items it did not receive.

Recommendation

- *MTI should maintain adequate supporting documentation for administrative expenditure transactions.*

3. MTI did not comply with its purchasing policy regarding some purchase orders.

MTI prepared purchase orders after services were provided. We found purchase orders that were signed and dated after goods or services were received for 14 of 34 sample items tested. MTI policy requires a signed purchase order prior to ordering goods and services and the receipt of an invoice. The purchase order documents the authorization to purchase.

Recommendation

- *MTI should prepare purchase orders prior to ordering goods and services.*

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Chapter 4. Grant Expenditures

Chapter Conclusions

MTI's internal controls provided reasonable assurance that its grant expenditures were properly authorized, supported, and recorded in the accounting system and in compliance with board policies and applicable legal provisions.

For the items tested, MTI complied with board policies and applicable finance-related legal provisions.

Audit Objectives

Our audit of MTI's grant expenditures focused on the following questions:

- Did MTI's internal controls provide reasonable assurance that its grant expenditures were properly authorized, supported, and recorded in the accounting system and in compliance with board policies and applicable legal provisions?

- For the items tested, did MTI comply with board policies and applicable finance-related legal provisions?

Background

MTI provided grant funds as a means to fulfilling its mission of assisting Minnesota companies to become more competitive through the application and development of technology. The funding sources for these programs included MTI's state appropriation and federal grants. MTI has a long-standing relationship with the U.S. Department of Commerce's National Institute of Standards and Technology (NIST). During the audit period, NIST provided MTI with approximately $6 million in grant funds. MTI's federally funded programs were audited annually in accordance with OMB Circular A-133, the Single Audit. Therefore, we did not review these programs.

As part of its operating appropriation, MTI receives funding for several outside organizations, as shown in Table 4-1. These legislative grants pass through MTI. MTI does not establish programmatic control over how these organizations use the funds. MTI typically disburses the total grant in a lump sum payment at the start of the fiscal year. MTI requires pass-through organizations to submit a statement of work and a budget, but does not monitor the activity.

Table 4-1
Pass-Through Funding By Recipient
Fiscal Years 2001-2002

	FY 2001	FY 2002
MN Investors Congress	$ 70,000	$ 50,000
MN Project Innovation	500,000	875,000
Natural Resources Research Institute	450,000	0
MN Cold Weather Research Center	100,000	0
	$1,120,000	$925,000

Note: The state did not appropriate pass-through funding for fiscal year 2003 and beyond.

Source: Minnesota Appropriation Laws for MTI for fiscal years 2001-2003.

There were no written findings as a result of our work on grants.

Status of Prior Audit Issues
As of June 4, 2004

Most Recent Audits

Legislative Audit Report 00-33, issued in July 2000, covered the three-year period ending June 30, 1999. The audit scope included payroll, administrative expenditures, fixed assets, and grants. The report did not contain any findings.

KPMG issued two audit reports to MTI dated December 12, 2003. The first report was a qualified opinion on MTI's financial statements as of June 30, 2003. The auditors were unable to obtain sufficient audit evidence to support MTI's accounting for its disposal of capital assets and the related carrying amount of capital assets and net assets invested in capital assets. The second report was on MTI's internal control over financial reporting and compliance with OMB Circular A-133. The report contained six findings related to MTI's compliance with its federal award from the U.S. Department of Commerce through the National Institute of Standards and Technology. The audit found that MTI did not comply with requirements regarding program income, allowable costs/cost principles, and procurement. The auditor selected to perform the audit of MTI's financial statements and the OMB Circular A-133 Audit for the year ended June 30, 2004, will follow up on the status of these findings.

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Minnesota Technology, Inc.

September 7, 2004

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

Dear Mr. Nobles:

This letter is in response to the audit findings letter from you dated August 23, 2004.

We appreciate the opportunity to respond to the findings and recommendations included in your report covering the three state fiscal years ending June 30, 2003. We found the information in your report and the exit meeting to be very informative and helpful in our continuing attempts to operate MTI in the best manner possible. The three findings and responses are listed here:

1. MTI did not have adequate separation of duties over the payroll process.

In late May 2004, the Company hired a full-time Controller/Director of Finance and in late July, an Associate Accountant was hired. Hiring both of these positions has allowed the Company to strengthen its internal controls and achieve the required separation of duties. These procedures were fully implemented as of August 15, 2004. The primary responsible party is the President and CEO and the Controller.

2. MTI did not maintain adequate supporting documentation for some administrative expenditure transactions.

We agree with your findings in this area and have already started to address this issue. To do so, MTI is formalizing its procedures related to the procurement process. The new procedures will be communicated company wide by the end of September 2004. The primary responsible party is the Controller with support from the entire Leadership Team.

3. MTI did not comply with its purchasing policy regarding some purchase orders.

We agree with your findings in this area and have already addressed this issue as of August 2004, by reinforcing the existing policy and retraining existing staff. The primary responsible party is the Controller with support from the entire Leadership Team.

I would like to thank your staff for the professional manner in which they conducted the audit. I also want to complement the expertise of your staff shown during the audit process. They were knowledgeable, good listeners, courteous, and patient as the audit progressed.

Thank you for the best opportunity to provide this response to your report.

Sincerely,

Wayne A. Pletcher, Ph.D.
President & CEO