



OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

FINANCIAL AUDIT DIVISION REPORT

Minnesota State Academies

Internal Controls and Compliance Audit

July 2009 through January 2013

October 3, 2013

Report 13-24

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OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

October 3, 2013

Senator Roger Reinert, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Brad Harper, Superintendent
Minnesota State Academies

This report presents the results of our internal controls and compliance audit of the Minnesota State Academies for the period from July 1, 2009, through January 31, 2013. The objective of this audit was to determine if the academies had adequate internal controls for its financial operations and complied with finance-related legal requirements.

We discussed the results of the audit with the academies' staff at an exit conference on September 24, 2013. This audit was conducted by Scott Tjomsland, CPA, CISA (Audit Manager), Pat Ryan (Auditor-in-Charge), and auditors Joe McMahon, CPA, Abdul Suleyman, CPA, and Heather Varez, CPA.

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

Handwritten signature of James R. Nobles in black ink.

James R. Nobles
Legislative Auditor

Handwritten signature of Cecile M. Ferkul in black ink.

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

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Report Summary

Conclusion

The Minnesota State Academies (academies) generally had adequate internal controls to ensure that it safeguarded its financial resources, accurately paid employees and vendors in accordance with management's authorizations, produced reliable financial data, and complied with finance-related legal requirements. For the items we tested, the academies generally complied with finance-related legal requirements. However, the academies had some internal control weaknesses and instances of noncompliance.

The academies resolved 15 of 16 prior audit findings.

Key Findings

- The Minnesota State Academies had not eliminated or mitigated the risk created by assigning employees incompatible security roles in the state's accounting system. ([Finding 1, page 7](#))
- The Minnesota State Academies had not adequately administered free and reduced student meals and meal ticket sales. ([Finding 2, page 7](#))
- The Minnesota State Academies had not reviewed employees' activity logs to ensure they billed school districts only for special education services provided. ([Finding 3, page 9](#))

Audit Objectives and Scope

Objectives

- Internal controls
- Legal compliance

Period Audited

- July 1, 2009, through January 31, 2013

Audited Areas

- Payroll expenditures
 - Selected revenues
 - Student account activity
 - Selected administrative expenditures
 - Local bank account and imprest cash activity
 - Computer system security access
-

Minnesota State Academies

Agency Overview

The Minnesota State Academies are two public schools, located in Faribault, Minnesota, that provide education and related services to students across the state, from birth to age 21, who are deaf, hard of hearing, blind, or visually impaired, including those with multiple disabilities.¹ The academies have provided educational services to deaf and blind students for about 150 years. The academies educate students (either directly on their Faribault campuses or through support to other public schools) to develop social skills, leadership skills, and specialized skills, such as sign language and Braille. During the 2012-13 school year, about 220 students attended the Faribault schools.

The academies' governing board consists of seven members and two ex-officio members appointed by the Governor with the advice and consent of the Senate. At least one member of the board must represent the blind community, and one member must represent the deaf community. Brad Harper is the academies' superintendent; he was appointed by the board of directors in June 2012. Linda Mitchell served as the prior superintendent.

The academies received General Fund appropriations of about \$11.9 million per year for fiscal years 2010 and 2011² and about \$11.6 million per year for fiscal years 2012 and 2013.³ The academies also generated revenue from grants, donations, seminars, and student fees. The academies' largest expenditure was payroll.

Table 1 summarizes the academies' appropriations, receipts, and expenditures for fiscal years 2010 through 2013.

¹ The two schools comprise Independent School District number 0160-70.

² *Laws of Minnesota* 2009, chapter 96, article 8, section 4.

³ *Laws of Minnesota* 2011, First Special Session, chapter 11, article 11, section 2.

Table 1
Minnesota State Academies
Appropriations, Receipts, and Expenditures¹
July 1, 2009, through June 30, 2013

| <u>Appropriations and Receipts</u> | Fiscal Years | | | |
|------------------------------------|---------------------|---------------------|---------------------|-------------------------|
| | <u>2010</u> | <u>2011</u> | <u>2012</u> | <u>2013²</u> |
| Appropriations | \$11,912,000 | \$11,912,000 | \$11,603,000 | \$11,603,000 |
| Grants | 3,030,433 | 2,378,894 | 1,897,709 | 2,431,505 |
| Donations ³ | 3,350 | 18,583 | 119,976 | 21,223 |
| Other Receipts | <u>283,434</u> | <u>437,644</u> | <u>343,662</u> | <u>365,773</u> |
| Total | <u>\$15,229,217</u> | <u>\$14,747,121</u> | <u>\$13,964,347</u> | <u>\$14,421,501</u> |
| | | | | |
| <u>Expenditures</u> | | | | |
| Payroll | \$12,456,905 | \$12,643,479 | \$12,421,644 | \$12,591,961 |
| Purchased Services | 1,015,254 | 842,266 | 701,218 | 981,120 |
| Supplies/Equipment | 541,171 | 578,389 | 410,765 | 534,378 |
| Travel/Employee Development | 106,714 | 98,414 | 33,385 | 44,433 |
| Other | <u>448,920</u> | <u>454,873</u> | <u>328,258</u> | <u>961,203</u> |
| Total | <u>\$14,568,964</u> | <u>\$14,617,421</u> | <u>\$13,895,270</u> | <u>\$15,113,095</u> |

¹The table does not include the financial activities of students' accounts.

²The scope of our audit did not include all fiscal year 2013 financial activity; it included financial activity through January 31, 2013.

³The academies received a \$97,400 donation from The Minnesota State Academy for the Blind Foundation in fiscal year 2012.

Source: State of Minnesota's accounting system.

Objective, Scope, and Methodology

The objective of our audit of the Minnesota State Academies for the period of July 1, 2009, through January 31, 2013, was to answer the following questions:

- Were the Minnesota State Academies' internal controls adequate to ensure that it safeguarded its financial resources, accurately paid employees and vendors in accordance with management's authorizations, complied with finance-related legal provisions, and created reliable financial data?
- Did the Minnesota State Academies comply with significant finance-related legal requirements?
- Did the Minnesota State Academies resolve prior audit findings?⁴

⁴ Office of the Legislative Auditor's Financial Audit Division Report 08-31, *Minnesota State Academies*, issued November 26, 2008.

To meet the audit objectives, we gained an understanding of the academies' financial policies and procedures. We considered the risk of errors in the accounting records and potential noncompliance with relevant legal requirements. We obtained and analyzed the academies' accounting data to identify unusual trends or significant changes in financial operations. We examined samples of financial transactions and reviewed supporting documentation to test whether the academies' controls were effective and if the transactions complied with laws, regulations, policies, 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 controls 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.⁵ We used state laws, regulations, and contracts, as well as policies and procedures established by the academies and the Department of Management and Budget as evaluation criteria over compliance.

Conclusion

The Minnesota State Academies generally had adequate internal controls to ensure that it safeguarded its financial resources, accurately paid employees and vendors in accordance with management's authorizations, produced reliable financial data, and complied with finance-related legal requirements. For the items we tested, the academies generally complied with finance-related legal requirements. The academies resolved 15 of 16 prior audit findings.

However, the academies had some internal control weaknesses and instances of noncompliance. The following *Findings and Recommendations* provide further explanation about the exceptions noted above.

⁵ 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.

Findings and Recommendations

The Minnesota State Academies had not eliminated or mitigated the risk created by assigning employees incompatible security roles in the state's accounting system.

Finding 1

The academies had five employees with security roles in the state's accounting system that allowed them to perform incompatible duties.⁶ In January 2013, the academies certified to the Department of Management and Budget that it had internal controls in place to mitigate the incompatible access risk, but the academies did not have documentation of those internal controls and could not show us how they were performed.

State policy requires agencies to eliminate incompatible access or, if elimination is not possible, have internal controls to mitigate the risk created by the incompatible access.⁷ Security access to perform incompatible duties allows one employee to complete a transaction without the review and approval of another employee. Separation of incompatible duties is a fundamental internal control designed to prevent erroneous or unauthorized transactions.

Recommendation

- *The academies should either eliminate employees' incompatible security roles or have internal controls in place to mitigate the risk created by the incompatible access.*

The Minnesota State Academies had not adequately administered free and reduced student meals and meal ticket sales.

Finding 2

The academies did not have adequate internal controls to ensure the accuracy of its records of free and reduced meals for students or the sales of meal tickets to staff and visitors.

The academies had not verified the accuracy of its determination of student eligibility for free or reduced price meals. One employee obtained and reviewed financial data about the students to determine their eligibility, but the academies did not review these determinations to ensure that errors had not occurred. In addition, the academies had not verified the accuracy of monthly meal counts reported to the Department of Education. The academies provide free or reduced

⁶ The Department of Management and Budget determined and identified for state agencies, including the Minnesota State Academies, the security roles that resulted in incompatible access to the state's accounting system.

⁷ Department of Management and Budget Policy 1101-07, *Security and Access*.

price meals to eligible students and obtained reimbursements based on meal counts submitted to the Department of Education. The Department of Education reimbursed the academies with federal grant funds available under the National School Lunch Program (CFDA 10.555) and School Breakfast Program (CFDA 10.553).⁸ In addition to being the basis for meal reimbursements, the number of students eligible for free or reduced price meals is a factor used by the Department of Education to allocate certain state education aids to school districts. Without a secondary review of student eligibility determinations and meal counts, there is an increased risk of error that could result in the school receiving benefits for ineligible students or inaccurate state education aid allocations.

We reviewed the academies' meal counts for October 2012 and found the following errors: the academies inaccurately totaled the meals recorded on several meal logs; the academies misclassified meals provided to several students as free instead of regular price; and the academies reported to the Department of Education 300 fewer free meals than it counted. Because of those errors, the academies' reimbursement was \$508 less than it should have been for that month.

Finally, the academies had not reconciled its log of meal ticket sales to the money deposited and recorded in the accounting system for those sales. At several locations, the academies sold sequentially numbered meal tickets to staff and visitors and maintained logs of meal tickets disbursed. However, because it did not reconcile those logs to the money deposited and recorded, there is an increased risk of errors and misappropriation occurring without detection. The academies recorded receipts from meal sales that did not exceed \$10,000 annually.

Recommendations

- *The Minnesota State Academies should verify the accuracy of student eligibility determinations for free or reduced price meals and the monthly meal counts submitted to the Department of Education.*
- *The Minnesota State Academies should reconcile the logs of meal tickets sold to money deposited and recorded on the accounting system.*

⁸ The Catalog of Federal Domestic Assistance (CFDA) is a unique number assigned by the federal government to identify its programs.

The Minnesota State Academies had not reviewed employees' activity logs to ensure they billed school districts only for special education services provided.

Finding 3

The academies did not have supervisors review and approve employees' activity logs of offsite special education services provided to school districts. The academies contracted with the school districts to provide the special education services at an hourly rate, plus mileage. The employees providing the services prepared monthly activity logs for each student served that listed the amount of time spent and mileage incurred. The academies used the logs to prepare quarterly invoices based on those logs. However, without supervisory review of the activity logs, there is an increased risk that errors on the logs could result in inaccurate billings to the school districts.

The academies annually received about \$144,000 from school districts for special education services.

Recommendation

- *The Minnesota State Academies should have supervisors review and approve employees' activity logs for special education services provided to school districts.*

The Minnesota State Academies did not monitor that its use of grant money complied with the terms of the grant agreements.

Finding 4

The academies did not adequately ensure it used grant money as required by the grantors. From July 2011 through January 2013, the academies received seven grants totaling \$17,100. One of those was a \$700 grant for a student field trip to Orchestra Hall; the grant agreement required the academies to return any unspent money. Documentation supporting the use of the grant showed that staff used \$178 of the grant for student activities not related to the field trip. Business office staff told us that an instructor was responsible for administering the grant; the instructor told them the grantor had verbally approved that the excess money could be used for other purposes rather than being returned. Without documentation of the grantor's approval, the academies were unable to support the appropriate use of the grant money.

Recommendations

- *The Minnesota State Academies should develop procedures to ensure it uses all grant money in compliance with the terms of the grant agreements.*
 - *The academies should return \$178 to the grantor.*
-

Finding 5

The Minnesota State Academies did not monitor the financial activities with its affiliated foundations.

The academies had not obtained certain financial reports from the two foundations that raise money for the benefit of the academies. The academies' contracts with these foundations (Minnesota State Academy for the Blind Foundation and Minnesota State Academy for the Deaf Foundation) required that they provide these reports to the academies. The contracts required the following reports: 1) the annual financial statement filed with the Office of the Attorney General;⁹ 2) an external audit report every three years; and 3) an annual report about fundraising activities, including the sources and amounts of donations. Review of these reports would allow the academies to ensure the financial integrity of the organizations and that they are acting in the best interest of the academies.

Because the academies had not obtained and reviewed the reports, it was not aware that the Office of the Attorney General no longer listed the Minnesota State Academy for the Deaf Foundation as an active charity and that the federal Internal Revenue Service had automatically revoked its tax exempt status because it had not filed required documents for three consecutive years.¹⁰

State statutes require charitable organizations to annually file with the Office of the Attorney General a registration statement, financial report, and copy of all tax or information returns (including all schedules and amendments) submitted to the Internal Revenue Service.¹¹ Noncompliance with these statutes prohibited the Minnesota State Academy for the Deaf Foundation from legally soliciting money, risked substantial civil penalties, and could have had a potential negative impact on the reputation of the academies.

Recommendation

- *The academies should obtain and review financial reports required by contract to be submitted by its affiliated foundations.*

⁹ *Minnesota Statutes* 2012, 309.53, subd. 1 requires certain charitable organizations to file reports with the Office of the Attorney General.

¹⁰ The Minnesota State Academy for the Blind Foundation did file required documents with the Attorney General and was listed as an active charity.

¹¹ *Minnesota Statutes* 2012, 309.52, subd. 1 and 309.53, subds. 1 and 2.

The Minnesota State Academies allowed an employee to use personal leave that had expired.**Finding 6**

The academies allowed an employee to use 16 hours of personal leave after the employee's right to use that leave expired. The applicable labor agreement stated that during the first six months of employment, the employee could use up to 16 hours of personal leave. However, the academies allowed the employee to use the personal leave after the initial six-month employment period, instead of requiring the employee to use accrued vacation hours.¹² When the employee subsequently left state employment, the academies paid the employee for unused vacation hours, including \$409 for the hours that should have been reduced instead of allowing the employee to use personal leave.

Recommendations

- *The academies should ensure that it only allows employees to use leave for which they are eligible.*
- *The academies should collect the overpayment from the former employee.*

Prior Finding Not Resolved: The Minnesota State Academies allowed two employees to accumulate travel benefits without ensuring those benefits would be used to reduce the cost of future state-paid travel.**Finding 7**

The academies did not adequately monitor the accrual and use of accumulated frequent flier miles or hotel rewards accrued by employees for state-paid travel. State policy,¹³ based on state statutes,¹⁴ prohibits employees from personal use of benefits issued as a result of state-paid travel.

In response to our prior audit recommendation, the academies stated that they had prohibited employees from purchasing their own airline tickets, "thereby eliminating any benefits gained for individual employees." However, documentation for two transactions we tested showed that one employee accrued benefits from an airline and another employee accrued benefits from a hotel. The academies did not have a policy requiring the employees to report those benefits so it could monitor them and ensure they were used to reduce future state-paid travel costs.

¹² Labor agreement between the State of Minnesota and the State Residential Schools Education Association for July 1, 2011, to June 30, 2013.

¹³ Minnesota Management and Budget Policy PAY0021, *Employee Business/Travel Expenses – Benefits Derived From Travel*.

¹⁴ *Minnesota Statutes* 2012, 43A.38, subd. 2, and *Minnesota Statutes* 2012, 15.435.

Recommendation

- *The academies should develop and monitor compliance with a policy to require employees to report benefits accrued on state-paid travel and to ensure that they are used to offset future state-paid travel costs.*
-



Minnesota State Academies

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September 26, 2013

Jim Nobles
Office of the Legislative Auditor
658 Cedar Street, Room 140
St. Paul, MN 55155-1603

Dear Mr. Nobles:

Enclosed you will find the Corrective Action Plan for the Minnesota State Academies recent audit.

If you should have any questions, please feel free to contact me at (507) 384.6601 or Michael Hopwood at (507) 384.6605

Sincerely,

Brad Harper
Minnesota State Academies Superintendent

CC: Michael Hopwood



Minnesota State Academies

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Minnesota State Academies Legislative Audit Report Corrective Action Plan Form

| Finding No. | Recommendation | Brief Explanation of Corrective Action Plan | Estimated Completion Date | Person Responsible |
|-------------|---|--|---------------------------|--|
| 1 | The Minnesota State Academies had not eliminated or mitigated the risk created by assigning employees incompatible security roles in the state's accounting system. | Finance Director reviewed the incompatible security report and eliminated roles where there was a conflict and reassigned. For those areas where elimination was not possible, internal controls will be put in place to mitigate the risk. | December 31, 2013. | Michael Hopwood |
| 2 | The Minnesota State Academies had not adequately administered free and reduced student meals for students. | Finance Director worked with MSA Dietary Director and created a process to ensure the accuracy of student's eligibility and also to verify the accuracy of monthly meal counts. | Completed. | Michael Hopwood Katy Roth |
| | The Minnesota State Academies had not adequately administered meal ticket sales. | Finance Director will create procedure to ensure the tracking and reconciliation of meal ticket sales. | Completed. | Michael Hopwood |
| 3 | The Minnesota State Academies had not reviewed employees' activity logs to ensure they billed school districts only for special education services provided. | Finance Director will make sure before invoices are approved to go out to school districts that Special ED Director has signed off on activity logs. | Completed. | Michael Hopwood |
| 4 | The Minnesota State Academies did not monitor that its use of grant money complied with the terms of the grant agreements. | Finance Director has created internal procedure with Fiscal Staff and MSA Staff that prior to expending any grant agreement dollars, all purchases are prior approved with Finance Director. Finance Director discussed with the grantor, and the grantor agreed to allow how \$57.85 of the \$178 was used and that \$120.15 was returned to the grantor. | Completed. | Michael Hopwood Fiscal Services Staff MSA Dept Heads |

Minnesota State Academies

| Finding No. | Recommendation | Brief Explanation of Corrective Action Plan | Estimated Completion Date | Person Responsible |
|--------------------|---|--|----------------------------------|---|
| 5 | The Minnesota State Academies did not monitor the financial activities with its affiliated foundations. | Finance Director will make sure to obtain and review financial reports that are required by contracts. | Completed. | Michael Hopwood |
| 6 | The Minnesota State Academies allowed an employee to use personal leave that had expired. | Finance Director will continue to audit payroll bi-weekly and will work with Human Resources and Payroll Department to ensure that only employees use leave for which they are eligible. Finance Director has invoiced the former employee for which overpayment was made. | Completed | Michael Hopwood Amber Gretz Martina Hagen |
| 7 | The Minnesota State Academies allowed two employees to accumulate travel benefits without ensuring those benefits would be used to reduce the cost of future state-paid travel. | Finance Director has updated Minnesota State Academies Special Expense Policy #701 to include all lodging and airline reservations will be made by Fiscal Services and billed to Minnesota State Academies. | Completed. | Michael Hopwood Patricia Rux |