



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

FINANCIAL AUDIT DIVISION REPORT

Agricultural Utilization Research Institute

Internal Controls and Compliance Audit

October 2011 through June 2014

October 2, 2014

Report 14-18

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OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA • James Nobles, Legislative Auditor

October 2, 2014

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Legislative Audit Commission

Members of the Legislative Audit Commission

Ron Obermoller, Chair
Agricultural Utilization Research Institute

Board of Directors
Agricultural Utilization Research Institute

Teresa Spaeth, Executive Director
Agricultural Utilization Research Institute

This report presents the results of our internal controls and compliance audit of the Agricultural Utilization Research Institute for the period from October 2011 through June 2014. The objectives of this audit were to determine if the institute had adequate internal controls over its financial operations and complied with finance-related legal requirements.

This audit was conducted by Kathy Rootham (Auditor-in-Charge) and auditors Cassandra Harlin and Nicholas Ludwig.

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

A handwritten signature in black ink that reads "James R. Nobles".
James R. Nobles
Legislative Auditor

A handwritten signature in black ink that reads "Cecile M. Ferkul".
Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

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Conclusion on Internal Controls

The Financial Audit Division bases its conclusion about an organization's internal controls on the number and nature of the control weaknesses we found in the audit. The three possible conclusions are as follows:

| Conclusion | Characteristics |
|--------------------|--|
| Adequate | The organization designed and implemented internal controls that effectively managed the risks related to its financial operations. |
| Generally Adequate | With some exceptions, the organization designed and implemented internal controls that effectively managed the risks related to its financial operations. |
| Not Adequate | The organization had significant weaknesses in the design and/or implementation of its internal controls and, as a result, the organization was unable to effectively manage the risks related to its financial operations. |

Report Summary

The Agricultural Utilization Research Institute, a legislatively created, nonprofit organization, receives annual appropriations from the state's General Fund, as well as money from project partnerships with other public and private organizations, federal grants, and other sources. It uses these resources to conduct research and promote new products that use Minnesota's agricultural commodities, such as corn or soybeans, while aiding the expansion of existing state commodity markets.

We examined the institute's internal controls over its financial operations and its compliance with finance-related legal requirements for the period from October 2011 through June 2014. Our review included money from all sources and expenses related to payroll, projects, administrative operations, and capital equipment costs.

Conclusion

We concluded that the Agricultural Utilization Research Institute's internal controls over its financial operations were adequate, and the institute complied with applicable finance-related legal requirements. Our audit did not result in any findings or recommendations.

Agricultural Utilization Research Institute

Agency Overview

The Agricultural Utilization Research Institute was created by the Legislature in 1989 as a nonprofit corporation.¹ *Minnesota Statutes 2013, 116V*, governs the institute's operations. *Minnesota Statutes 2013, 116V.01*, subd. 1, states:

The Agricultural Utilization Research Institute shall conduct onsite and applied research, promote the establishment of new products and product uses and the expansion of existing markets for the state's agricultural commodities and products, including direct financial and technical assistance for Minnesota entrepreneurs. The institute must establish or maintain facilities and work with private and public entities to leverage the resources available to achieve maximum results for Minnesota agriculture.

State law also provides that the institute shall be governed by a nine-member board of directors, comprised of two legislators, two representatives of statewide farm organizations,² two representatives of agribusiness,³ and three representatives of commodity research and promotion councils.⁴ Since being appointed by the board in 2006, Teresa Spaeth has been the institute's executive director, having previously served as its finance director. The institute has four offices:

- The Crookston office has research facilities and staff offices, along with the institute's administrative staff.
- The Marshall office has research facilities and staff offices.
- The Waseca office has research facilities and staff offices.
- The Saint Paul office has staff offices.

The institute conducts a significant amount of its work on a project basis. According to our understanding, projects are focused on one or more of the following three areas: (1) generating ideas for new opportunities in agricultural innovation; (2) further developing those opportunities having the best chance for success; and (3) implementing new products or methods in the marketplace to

¹ *Laws of Minnesota 1989*, chapter 350, art. 7.

² What constitutes a "statewide farm organization" is not defined in law. However, since the board was created, those positions have been held by representatives of the Minnesota Farmers Union and the Minnesota Farm Bureau Federation.

³ Merriam-Webster dictionary defines agribusiness as, "an industry engaged in the producing operations of a farm, the manufacture and distribution of farm equipment and supplies, and the processing, storage, and distribution of farm commodities."

⁴ Minnesota has 13 research and promotion councils, representing the following commodities: barley, beef, canola, corn, dairy, dry edible bean, potato (2 councils representing different areas of the state), soybean, sunflower, turkey, wheat, and cultivated wild rice.

grow businesses and create jobs. Projects must benefit Minnesota agricultural commodities or Minnesota companies.

Types of Projects - Projects are classified based on project financial arrangements and commitment of the institute's staff time. Project classes are:

- **Collaborations.** The institute partners with a commodity research and promotion council or another agricultural-related entity. The institute and the partner commit to a level of funding and a split of project expenses, along with institute staff time. The institute acts as the fiscal agent for the project; paying project costs and invoicing the partner for its share of project costs.
- **Client-driven.** The institute commits to a level of funding for the project with the project partner, which includes institute staff time, as well as laboratory resources. Some projects used institute staff and laboratory facilities exclusively. Other projects used external laboratory facilities for research and product development and minimal institute staff time to manage the project and provide scientific oversight. The project partner periodically submits proof of outside research expenses, which the institute reimburses. The institute requires project progress reports with the reimbursement request.
- **Institute-driven.** The institute also conducts its own agricultural commodity-based research and makes the results available to the Minnesota agricultural and business communities. In a major initiative that has developed over the last two years, the institute is working with multiple partners—large businesses, government, agriculture leaders, local economic developers, and many others—to implement an ag-bioscience strategy for Minnesota.

Appropriations and Receipts. The Legislature appropriated to the Institute \$2.643 million each year from the General Fund for fiscal years 2012 and 2013,⁵ and \$3.643 million for fiscal year 2014.⁶

The institute's accounting records show that, in addition to state appropriations, it received money from the following sources during fiscal years 2012, 2013, and 2014,⁷ through June 30, 2014:

- **Project Partners.** For collaboration projects, the institute received money from commodity promotion councils and other agricultural project partners. The institute received most of this money through project

⁵ *Laws of Minnesota* 2011, chapter 14, art. 1, sec. 5.

⁶ *Laws of Minnesota* 2013, chapter 114, art. 1, sec. 5; *Laws of Minnesota* 2013, chapter 143, art. 13, sec. 2.

⁷ The institute's fiscal year is from October 1 through September 30.

partnerships with the Minnesota Corn Research and Promotion Council and the Minnesota Soybean Research and Promotion Council.

- **Federal Grants.** The institute received money from the federal government as reimbursements for work it did on federal grants. The institute obtained grants from the U.S. Department of Agriculture and the U.S. Department of Energy.
- **Other Revenues.** The institute received money from a variety of other sources, including grants from foundations, investment income, patent royalties, and the sale of unused assets.

Table 1 summarizes the institute's revenues for fiscal years 2012, 2013, and 2014, through June 30, 2014.

Table 1
Agricultural Utilization Research Institute
Sources of Financial Resources
Institute Fiscal Years 2012 through 2014
(through June 30, 2014)

| | Institute Fiscal Years ¹ | | |
|--|-------------------------------------|--------------------|-------------------------|
| | <u>2012</u> | <u>2013</u> | <u>2014²</u> |
| State General Fund Appropriations ³ | | | |
| 2012 Appropriation ⁴ | \$1,982,250 | - | - |
| 2013 Appropriation | 660,750 | \$1,982,250 | - |
| 2014 Appropriation | - | 910,750 | \$2,732,250 |
| Partner Projects | | | |
| Minnesota Corn Research and Promotion Council | 252,688 | 621,184 | 310,714 |
| Minnesota Soybean Research and Promotion Council | 57,398 | 111,952 | 53,957 |
| Other Partners | 312,914 | 34,568 | 40,000 |
| Federal Grants ⁵ | 213,684 | 142,438 | 43,968 |
| Other Revenues | <u>485,161</u> | <u>285,630</u> | <u>122,083</u> |
| Total Sources | <u>\$3,964,845</u> | <u>\$4,088,772</u> | <u>\$3,302,972</u> |

¹ The institute's fiscal year is October 1 through September 30.

² Fiscal year 2014, which ended on September 30, 2014, includes financial activity for three quarters, through June 30, 2014.

³ Because the institute's fiscal year does not align with the state's fiscal year (which is from July 1 through June 30), the General Fund appropriations cross-over fiscal years.

⁴ The institute recognized \$660,750 of the 2012 General Fund appropriation in fiscal year 2011.

⁵ Federal grants declined during fiscal years 2013 and 2014 because the grant periods ended.

Expenditures. The institute's primary expenditure categories were:

- **Payroll.** Costs included compensation and benefits to employees. Although institute employees are not state employees, state statute allows them to participate in state retirement and insurance plans.⁸
- **Project.** Costs included external research, product development, and marketing goods and services. Costs to be reimbursed by federal grants are also recorded as project costs.
- **Administrative.** Costs included employee travel, office and research facility rent, per diem payments to board members,⁹ contracted services,¹⁰ capital equipment,¹¹ and other costs related to the institute's operations.

Table 2 summarizes the institute's spending for fiscal years 2012, 2013, and 2014, through June 30, 2014.

⁸ Minnesota Statutes 2013, 116V.01, subd. 4.

⁹ Per diem is the payment a board member receives for participating in official board functions, such as board meetings. The board's per diem amount for fiscal year 2014 was \$77 per day.

¹⁰ The board contracted for payroll processing, information technology, audit, website development, and other services.

¹¹ Capital equipment purchases included scientific and lab equipment and other capital assets costing more than \$2,000, as well as computers and information technology equipment costing more than \$500.

Table 2
Agricultural Utilization Research Institute
Uses of Financial Resources
Institute Fiscal Years 2012 through 2014
(through June 30, 2014)

| | Institute Fiscal Years ¹ | | |
|-----------------------|-------------------------------------|--------------------|-------------------------|
| | <u>2012</u> | <u>2013</u> | <u>2014²</u> |
| Payroll | \$2,028,457 | \$2,319,346 | \$1,719,477 |
| Project Costs | 1,523,118 | 1,363,785 | 721,328 |
| Administrative Costs: | | | |
| Travel | 210,538 | 230,679 | 173,436 |
| Rent | 198,441 | 213,506 | 170,638 |
| Contracted Services | 154,411 | 158,496 | 96,547 |
| Board Per Diem | 11,473 | 12,755 | 6,859 |
| Other Administration | 344,481 | 366,303 | 278,930 |
| Capital Equipment | <u>230,584</u> | <u>107,116</u> | <u>35,157</u> |
| Total Uses | <u>\$4,701,503</u> | <u>\$4,771,986</u> | <u>\$3,202,372</u> |

¹ The institute's fiscal year is October 1 through September 30.

² Fiscal Year 2014 includes three quarters, through June 30, 2014.

Source: Agricultural Utilization Research Institute's accounting system.

Objectives, Scope, and Methodology

The objective of our audit was to answer the following questions related to the financial operations of the Agricultural Utilization Research Institute during the period of October 2011 through June 2014:

- Did the Agricultural Utilization Research Institute have adequate internal controls 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 Agricultural Utilization Research Institute comply with significant finance-related legal requirements?

We used several sources to evaluate internal controls and compliance. To evaluate the institute's controls, we used the guidance contained in the *Internal Control-Integrated Framework*, published by the Committee of Sponsoring

Organizations of the Treadway Commission.¹² To evaluate compliance, we primarily used:

- *Minnesota Statutes 2013, 116V.*
- The Agricultural Utilization Research Institute's Board Policies.
- The Agricultural Utilization Research Institute's Human Resources Policies.

To meet the audit objectives, we interviewed staff to gain an understanding of the institute's financial policies and procedures. We considered the risk of errors in the accounting and payroll records and potential noncompliance with relevant legal requirements. We obtained and analyzed accounting data from the institute's accounting and payroll systems to identify unusual trends or significant changes in financial operations.¹³ We also examined samples of financial transactions and reviewed supporting documentation to test whether the institutes' controls were effective and if the transactions complied with laws, policies, and contracts.

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.

More specifically, our testing of significant financial areas and controls included the following:

- **Receipts.** The institute received most of its money through electronic fund transfers directly into its bank account, which significantly reduces the risk of loss or theft. To ensure that the institute adequately safeguarded other money it received through the mail, we tested a sample of deposits to ensure that staff deposited all receipts in the bank and accurately recorded those deposits in the accounting records. We also reviewed a sample of the institute's reconciliations of its bank accounts and investment accounts to its accounting records to (1) ensure that it recorded all receipt activity in the financial records and (2) promptly identified and resolved any account discrepancies. We also reviewed the institute's accounts receivable reports to ensure that the institute did not allow costs billed to project partners to go unpaid.
- **Payroll.** We analyzed the institute's payroll transactions (including pay rates for newly hired staff, vacation and sick leave accruals, pay increases,

¹² 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.

¹³ The institute does not use the state's accounting and payroll systems.

overtime pay, education reimbursements, and severance pay) using data from the institute's payroll processing service provider. We analyzed payments to the state's Department of Management and Budget and the state retirement systems for insurance and retirement benefits. We requested documentation for all unusual items found in our analysis to determine whether those transactions were authorized and reasonable.

In addition, we tested staff timesheets to ensure that hours recorded to projects were supported by timesheets completed by the employees and authorized by their supervisors.

- **Project Expenditures.** We tested a sample of project costs to ensure that they were reasonable and necessary to the purposes of the project. We also performed testing to ensure that the institute accurately billed project partners for their share of project costs and credited project partner payments to the correct project.
- **Administrative Costs.** We analyzed rent transactions and traced payments to authorized lease agreements. We tested samples of travel, board per diem, and contracted services transactions to determine whether they were accurately paid, authorized, and followed board policies. We tested a sample of capital equipment purchases, as these larger dollar items typically required bids to ensure that the institute obtained the best purchase value. We also examined the institute's capital equipment inventory. We analyzed all other administrative costs and reviewed documentation supporting certain items to determine whether they were authorized and followed board policies.
- **System Security Access.** We gained an understanding of the institute's accounting and payroll systems and how employees used those systems to perform their work. We reviewed the institute's process to review and approve requests for employee access to those systems. We reviewed the access employees had to the institute's systems as of August 2014 to ensure that the access each employee had was reasonable, based on our understanding of the employees' job responsibilities and duties.

Conclusion

We concluded that the Agricultural Utilization Research Institute's internal controls over its financial operations were adequate, and the institute complied with applicable finance-related legal requirements. Our audit did not result in any findings or recommendations.
