Office of the Legislative Auditor

State of Montana

Report to the Legislature

April 1990

Financial-Compliance Audit

For the Two Fiscal Years Ended June 30, 1989

Montana State University

Agricultural Experiment Station
Extension Service

This report contains recommendations which address the following issues:

- Adequacy of management controls to ensure MSU complies with grant provisions. This resulted in $1.1 million of questioned costs.
- Compliance with state purchasing laws and regulations.
- Cash management procedures which resulted in $392,000 lost investment income over the last six years.
- Compliance with state policy for non-treasury cash accounts.
- Compliance with appropriation reversion laws and laws requiring spending non-General Fund money first which resulted in $207,000 due the General Fund.
- Accounting and reporting to provide complete and accurate financial information.

Direct comments/inquiries to:
Office of the Legislative Auditor
Room 135, State Capitol
Helena, Montana 59620

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FINANCIAL-COMPLIANCE AUDITS

Financial-compliance audits are conducted by the Office of the Legislative Auditor to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations which could have a significant financial impact. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States General Accounting Office. Financial-compliance audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

The Single Audit Act of 1984 and OMB Circular A-128 require the auditor to issue certain financial, internal control, and compliance reports regarding the state's federal financial assistance programs, including all findings of noncompliance and questioned costs. This individual agency audit report is not intended to comply with the Single Audit Act of 1984 or OMB Circular A-128 and is therefore not intended for distribution to federal grantor agencies. The Office of the Legislative Auditor issues a statewide biennial Single Audit Report which complies with the reporting requirements listed above. The Single Audit Report for the two fiscal years ended June 30, 1987 has been issued. Copies of the Single Audit Report can be obtained by contacting:

Office of the Legislative Auditor
Room 135, State Capitol
Helena, MT 59620

STATE OF MONTANA

Office of the Legislative Auditor

STATE CAPITOL
HELENA, MONTANA 59620
406/444-3122

LEGISLATIVE AUDITOR:
SCOTT A. SEACAT

LEGAL COUNSEL:
JOHN W. NORTHEY

DEPUTY LEGISLATIVE AUDITORS:
MARY BRYSON
Operations and EDP Audit
JAMES GILLETT
Financial-Compliance Audit
JIM PELLEGRINI
Performance Audit

April 1990

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial-compliance audit report on the Montana State University, Extension Service, and Agricultural Experiment Station financial activity for fiscal years 1987-88 and 1988-89. The university's written response to audit recommendations is included in the back of the audit report.

We thank President Tietz and his staff for their cooperation and assistance throughout the audit.

Respectfully submitted,

Scott A. Seacat

Scott A. Seacat
Legislative Auditor

Office of the Legislative Auditor

Financial-Compliance Audit
For the Two Fiscal Years Ended June 30, 1989

Montana State University

Agricultural Experiment Station
Extension Service

Members of the audit staff involved in this audit were Pearl M. Allen, Laurie Evans, Boyd D. Gackle, Charles V. Jensen, Wayne Kedish, Jim Manning, and Rich McRae.

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Appointed and Administrative Officials

Board of Regents of Higher Education

		Term Expires
Stan Stephens, Governor*		1992
Nancy Keenan, Superintendent of Public Instruction*		1992
William Mathers, Chairman	Miles City	1994
Elsie Redlin, Vice Chairman	Lambert	1991
Jim Kaze	Havre	1992
Tom Topel	Billings	1993
Cordell Johnson	Helena	1996
Kermit R. Schwanke	Missoula	1997
Vickie Rae Clouse, Student Regent	Havre	1990

*Ex officio members

Commissioner of Higher Education

Dr. Carrol Krause
Commissioner of Higher Education

John H. Noble, Jr.
Deputy Commissioner for Management and Fiscal Affairs

Montana State University

Dr. William Tietz, President

Dr. James Welsh, Director of Agriculture and Extension

Dr. James Isch, Vice President for Administration

Dr. John W. Jutila, Vice President for Research

Dr. Michael Malone, Acting Vice President for Academic Affairs

This listing serves as a means of summarizing the recommendations contained in the report and the audited university's reply.

Summary of Recommendations

Introduction

Introduction

We performed a financial-compliance audit of Montana State University (MSU) and the related Extension Service (ES) and Agricultural Experiment Station (AES) for the two fiscal years ended June 30, 1989. The objectives of the audit were to:

1. Determine if the university complied with applicable laws and regulations which could have a significant effect on the financial statements.

2. Make recommendations for improvements in the management and internal accounting controls of the university.

3. Determine if the financial statements present fairly the financial position and results of operations of the university for the two fiscal years ended June 30, 1989.

4. Determine the implementation status of prior audit recommendations.

This report contains 15 recommendations which address areas where administrative and accounting controls, compliance with laws and regulations, and accountability can be improved. Other areas of concern deemed not to have a significant effect on the successful operations of the university programs are not specifically included in the report, but have been discussed with management.

In accordance with section 5-13-307, MCA, we analyzed the costs of implementing the recommendations made in this report. Each report section discloses the cost, if significant, of implementing the recommendation.

Background

Montana State University was founded on February 15, 1893, as the Agricultural College of the state of Montana. The school was later named Montana State College, and on July 1, 1965, it became Montana State University (MSU). The university is a land-grant institution as authorized by the Morrill Act of 1862 and receives part of its support from land-grant income, as well as state appropriations, student fees, and federal and private grants.

The public service function of the university had its origin in the establishment of the Extension Service (ES) in 1915, created under the federal Smith-Lever Act and state legislation. Financial support for its operation comes from county, state, and federal governments, as well as from federal and private grants. County agents and specialists are an integral part of the university and channel information to Montanans to aid in solving home, farm, and community problems.

The Agricultural Experiment Station (AES) is also an integral part of the university. It was established in 1893 by the Montana Legislature under authorization provided by the federal Hatch Act of 1887. The station receives federal funds under the Hatch Act, as well as state appropriations, federal and private grants, and funds from the sale of surplus agricultural products. The Agricultural Experiment Station has eight locations in the state, in addition to the Bozeman campus. The station components are devoted to solving agricultural and land reclamation problems of local, regional, and national concern. The distribution of research centers is such that the peculiarities of local or area soil, water, and climate can be considered.

The president of Montana State University is the chief executive officer for all three units: MSU, AES, and ES. The president is responsible for the immediate direction, management, and control of the institution under the general supervision and direction of the Board of Regents. Effective July 1, 1987, AES and ES consolidated their administrative functions. However, AES and ES continue to receive separate funding and budgets.

According to estimates provided by the Office of Commissioner of Higher Education, the University, AES, and ES had approximately 2,200 employee FTEs during fiscal year 1988-89. The number of FTE by classification is shown in the following schedule:

"UNAUDITED"
Estimated Employee FTE
Fiscal Year 1988-89

	MONTANA STATE UNIVERSITY		
	Appropriated Fund	Nonappropriated Funds [1]	Total
Contract Faculty	497.00	104.93	601.93
Contract Professional and Administration	116.10	32.74	148.84
Classified	290.51	201.05	491.56
Grad. Teach. Asst.	57.51	1.69	59.20
Grad. Research Asst.	5.40	47.82	53.22
Part-time and Other	83.22	334.77	417.99
Total	1,049.74	723.00	1,772.74

	AGRICULTURAL EXPERIMENT STATION		
	Appropriated Fund	Nonappropriated Funds	Total
Contract Faculty	91.30	-	91.30
Contract Professional and Administration	30.33	-	30.33
Classified	105.37	9.51	114.88
Grad. Research Asst.	16.00	.50	16.50
Part-time and Other	16.92	3.86	20.78
Total	259.92	13.87	273.79

	EXTENSION SERVICE		
	Appropriated Fund	Nonappropriated Funds	Total
Contract Faculty	81.46	11.98	93.44
Contract Professional and Administration	11.11	3.07	14.18
Classified	22.03	21.00	43.03
Part-time and Other	1.17	8.22	9.39
Total	115.77	44.27	160.04

[1]Includes Restricted Fund by classification.

Compiled by the Commissioner of Higher Education.

Prior Audit Recommendations

Our financial-compliance audit of the university for the two fiscal years ended June 30, 1987, contained nine recommendations. The university implemented five of the recommendations, and partially implemented four of the recommendations. Three recommendations which were partially implemented concern cash management practices, as discussed on page 18, use of the contingent revolving fund, as discussed on page 27 and recording "fixed price contracts", as discussed on page 31. The fourth recommendation partially implemented concerning budget amounts approved by the Board of Regents has been discussed with management.

Findings and Recommendations

Management Controls

Primary functions of management include organizing, directing, and controlling the activities of an entity in order to accomplish the objectives of the entity. The methods management adopts to carry out these management functions constitute the management control environment.

We noted instances where management control over budgets and compliance with university, state, and federal policies and laws should be improved. The following sections discuss recommendations for strengthening management controls and improving university operations.

Grants and Contracts

The university receives funds from federal, state, and private sources for research, instruction, or other projects conducted by the university. The Grants and Contracts (G&C) Office at MSU, under the direction of the Vice President for Research, oversees projects sponsored by grants or governed by contracts. The G&C Office also controls the indirect cost recoveries received by the university. A coordinator, or principal investigator, heads each project and is responsible for preparing and submitting the project proposal, conducting the research or other project objectives and summarizing and reporting results. The principal investigator assumes the primary responsibility for monitoring the grant progress and compliance with the specific grant agreement when he or she agrees to be the principal investigator for the grant. Because projects are numerous and varied in nature, G&C personnel depend on principal investigators, who are most familiar with projects, to monitor spending for compliance with provisions of contracts and grant agreements.

Total expenditures from all grants and contracts sources were $14.9 million for fiscal 1987-88 and $15.7 million for fiscal year 1988-89. Of these amounts, expenditures charged to federal grant projects totaled $8.7 million in fiscal year 1987-88 and $8.9 million in fiscal year 1988-89. Grants from the following federal agencies were the primary federal sources, accounting for expenditures over $1 million each year during the audit period: U.S. Department of Health and Human Services (HHS); U.S. Department of Agriculture (USDA); and National Science Foundation (NSF).

During the audit period, the university's management control system over grant and contract operations was not adequate. The university's grant control system failed to prevent budget overruns, identify unallowable costs, and ensure timely, accurate records of grant expenditures. The control weaknesses discussed in this report on pages 6 through 25, are cross cutting issues which potentially affect all departments and programs. Although many of the more significant examples of errors and noncompliance occurred within the authority of one campus department, other examples demonstrate the control systems were not operating effectively and did not ensure compliance with laws, regulations, policies, budget restrictions, and specific grant restrictions on a campus wide basis. The following sections discuss specific control weaknesses noted in the grants control system.

MSU Should Improve Controls to Prevent Budget Overruns

MSU management should improve budgetary controls over grants and contracts. We noted projects had overspent budgets or overspent budget categories specified in grant agreements and contracts. As of June 30, 1989, fourteen projects in eight university departments had budget overruns (cash deficits) totaling $631,690. The overruns ranged from $3,052 to $151,761. At least two of these deficits have existed for more than six years. The university's internal auditor also noted this problem in a May 1989 report involving one department of the university. The internal auditor noted 5 out of 43 G&C accounts for the department had expenditures recorded in excess of the authorized levels. The deficits noted by the internal auditor totaled $191,111 which is included in the $631,690 above.

By spending more than grantors award MSU, principal investigators force the university to absorb extra costs. Agency personnel suggested deficits might eventually be paid for by using indirect cost recoveries. MSU management needs to implement a formal plan to eliminate the cash deficits caused by overspending in the G&C accounts. In February 1990, we discussed this problem with MSU officials. The Vice President for Research provided documentation that he has plans in place to eliminate $181,875 of the cash deficits during fiscal year 1989-90. This amount will be eliminated using indirect cost recoveries or other sources. $86,802 has been obligated to the G&C debt retirement pool for liquidation during fiscal years 1990-91 and 1991-92 using indirect cost recoveries. According to the Vice President of Research the remaining balance of $363,013 is the responsibility or various departments. The Vice President stated if no solutions or debt retirement plans are provided by the department by the end of fiscal year 1989-90, the remaining deficits will be eliminated during fiscal years 1990-91 and 1991-92 using future indirect cost recoveries.

MSU records such cash deficits as receivables at year-end. The amounts are not valid receivables from sources outside MSU. By recording receivables for the overruns, the university overstated receivables in the restricted fund $596,040 and $631,690 in fiscal years 1987-88 and 1988-89, respectively.

Two of the fourteen projects are federal grants from the National Institute of Health (CFDA #13.867). Costs in excess of the approved grant budget are unallowable costs under federal regulations. Therefore, the cash deficits for these two projects which total $165,782 are questioned costs. Because MSU has not collected the $165,782 from the federal grantor this amount does not represent a potential liability which must be repaid to the federal government. However, costs in excess of approved budgets must be funded from other university sources.

MSU officials may decide the overruns will be paid out of departmental operating budgets in the Unrestricted Fund or through other funding mechanisms such as future indirect cost recoveries as noted above. Once the decision has been made, MSU should move the expenditures to the appropriate fund.

Recommendation #1

We recommend MSU implement a formal plan to eliminate cash deficits caused by overspending in grant and contract accounts.

Budgetary Controls

Top levels of university management need to be involved to establish responsibility and strengthen budgetary controls. In response to the May 1989 internal audit, department officials stated the department does not have sufficient budget information on a timely basis to keep the principal investigators from overspending. The department officials stated the academic dean or department head have no control or authority over the G&C accounts and thus the department cannot assume responsibility for the deficits. Department officials stated the Vice President for Research and the G&C office were responsible for the deficits.

In February 1990, we discussed budgetary controls with MSU officials. The Vice President for Research noted his frustration in trying to control budget overruns by the principal investigators because he has limited control over the principal investigators. The responsibility and authority to control budget overruns is an issue which management must address. Under current university procedures all grant proposals must be approved by the department head and dean of the college before they are presented to the Vice President for Research. Expenditures and vendor payment authorizations require department approval before being processed by the G&C office. Therefore, the departments share responsibility for budgetary controls. G&C personnel stated the overspending results from the principal investigators' failure to use the budgetary information supplied to them on a routine basis and the principal investigators not monitoring grant expenditures for compliance with authorized budgets. Important budget information, including documentation of expenditures and communications between the principal investigator and the grantor, often does not reach the G&C Office on a timely basis. Examples of untimely information transmitted to the G&C Office include:

1. Equipment totaling $21,198, was ordered by a principal investigator in June 1987 and delivered in August 1987. This equipment was not initially encumbered against the grant (U.S. Department of Education, CFDA #84.031). University officials stated the equipment was originally going to be paid from an account in the Designated Subfund. Department officials determined there was no money available in the Designated Subfund to pay for the equipment. The university did not pay for the equipment until December 1988, when the principal investigator requested the equipment be charged against the grant. The vendor was paid 16 months after the payment was due. MSU incorrectly recorded the December 1988 payment as a fiscal year 1988-89 expenditure. The expenditure should have been recorded as a fiscal year 1987-88 expenditure (August 1987) when the equipment was received. State law, section 17-8-242, MCA, requires an agency to pay bills on a timely basis. In order to promptly pay vendors and ensure expenditures are recorded in the proper year, principal investigators should ensure that equipment purchases and vendor invoices are promptly submitted for payment.

2. A principal investigator received $11,924 of equipment in October 1988 for a federal grant (HHS CFDA #13.999) as part of a larger equipment acquisition. The investigator did not notify the G&C office until September 1989 when the vendor stopped all further credit sales to the university and threatened legal action to collect the past due account. State law, section 17-8-242, MCA, requires an agency to pay bills on a timely basis and provides for interest on past due accounts. The principal investigator's failure to promptly notify the G&C office could result in additional cost to the university for interest on past due accounts. The interest costs if assessed would not be allowable charges to federal grants.

3. A private grant file did not reflect the grantor's revised budget because the principal investigator did not send the information to the G&C Office. When the grant closed, G&C's expenditure records did not support the expenditures on the final report submitted to the grantor. G&C

personnel stated the principal investigator prepared the final report, without coordinating with the G&C office.

Without timely and complete information concerning budgets, expenditures and other contractual agreements, G&C personnel cannot adequately monitor project spending. Incomplete documentation in grant files is discussed later in this report (page 13). University personnel stated principal investigators and their superiors sometimes ignore or override G&C personnel's warnings about budget overruns and requests for additional documentation.

Management has been slow to respond to these warnings of budgetary overruns as evidenced by the $631,690 discussed on page 6. Cash deficits caused by overspending can result in increased use of state General Fund moneys. The university should correct weaknesses in the present budgetary management system and ensure future spending of private, state, and federal grant money complies with applicable budgets.

University officials explained that in order to more closely monitor expenditures the G&C computer system was programmed in fiscal year 1989-90, to stop processing financial activity related to a project when spending approached the budgeted limit. Limiting recorded expenditures to the authorized budget amounts does not address the control problems of investigators exceeding budget unless the limitation is enforced. Management must fix responsibility and strengthen controls to hold the principal investigators accountable for expenditures charged to grants and contracts. Control procedures (some of which are already in place, but not always adhered to) could include: 1) obtaining prior management approval for all major expenditures over a specified dollar amount; 2) requiring principal investigators to provide more timely and complete information to ensure the G&C system presents accurate, up-to-date budgetary information; 3) implementing procedures for the G&C office to monitor and report problems to management; and 4) management taking appropriate disciplinary action to resolve problems. The cooperation and resolve of MSU management and principal investigators is needed to adequately monitor budgets and comply with contractual provisions.

As discussed in the following sections, MSU must also address expenditures without funding sources, improve grant file documentation, provide for accurate accounting, and comply with state purchasing laws in order to develop adequate administrative and accounting controls over the G&C process.

Recommendation #2

We recommend MSU management:

A. **Implement procedures to strengthen budgetary controls over grants and contracts.**

B. **Establish responsibility for overspending by principal investigators.**

C. **Require principal investigators to provide more timely information to the Grants and Contracts Office.**

D. **Monitor expenditures more closely for compliance with the established budgets.**

Expenditures Without Funding Sources

MSU spent money for projects although funding was not yet available or the source was not yet known. Incurring expenditures prior to obtaining a specific funding source contributes to the budgetary and cash deficit problems previously discussed on pages 6 through 11. The following examples were noted during our audit.

1. MSU spent $16,281 of restricted funds as a federal grant expenditure although MSU does not have a federal grant award for the money (NSF CFDA #47.999). Agency personnel said they received a verbal commitment and authorization to exercise pre-award expenditures from an existing G&C account for $20,000 from the National Science Foundation in 1988, but as of October 1989 have received no written award yet. Since MSU has no contract

for the funding, the project expenditures of $16,281 increase the cash deficit in the G&C accounts and are a potential Unrestricted Fund cost to the university if the anticipated grantor does not formally award the funds to MSU. If the university had pre-award authorization for these expenditures the university should have either recorded the expenditures under the existing account or transferred $20,000 authority from the existing account to the new project. By not recording expenditure with the related authority MSU increases the potential for expenditures to exceed amounts authorized by the grantor.

2. In September 1987 MSU officials agreed to finance the $130,000 renovation of a laboratory for a newly hired professor. Under the terms of the renovation agreement the G&C office established an $80,000 budget funded from designated fund indirect cost recoveries earned in fiscal year 1987-88 and the professor's department was to provide the remaining $50,000 over a three year period. As of September 1989, expenditures for the renovation project totaled approximately $105,400. However, the department did not have any funds available for amounts over the $80,000 provided by the G&C Office. As a result, a $35,145 contractor payment was paid out of the Physical Plant budget in the unrestricted fund. This reduced the funds available for planned maintenance projects.

   University officials explained in February 1990 that this project should have been accounted for in the Plant Funds rather than the designated G&C account. The officials stated the department is still responsible for expenditures in excess of the $80,000 budget in the G&C account. Officials anticipate correcting the department expenditures during the current fiscal year.

3. The university maintains a "mini rentals" account in the designated fund. The account is administered by the Vice President for Research. The mini rentals account is used to pay faculty start up costs, reimburse the MSU Foundation for equipment purchased on behalf of MSU, and in some instances, pay for equipment purchased by MSU for various departments. The mini rentals account is supposed to be reimbursed with regular payments by the department receiving the equipment. At the time the equipment is acquired, the department heads make a commitment for regular payments. However, some departments have been unable to meet those commitments. During the audit period the mini rentals account consistently operated with a deficit

cash balance. The cash deficits were $124,135 at fiscal year-end 1987, $131,681 at fiscal year-end 1988, and $167,665 at fiscal year-end 1989. Officials explained $90,000 of the 1989 deficit was for a faculty start up equipment purchase. The Vice President for Research must find other methods to eliminate the cash deficits. Officials stated they intend to use indirect cost recoveries on future grants. University officials said they discontinued use of the mini rentals account as of September, 1989, and said they will not allow any additional equipment acquisitions until the deficits have been eliminated.

University officials should ensure there is a reliable funding mechanism available before making payment commitments in the G&C accounts.

Recommendation #3

We recommend MSU obtain written documentation of grant awards and secure funding sources before expending funds for grants and contracts projects.

Grant File Documentation

We noted a need for improved documentation in some of the grant files we reviewed. Specific examples of problems caused by inadequate documentation are discussed in the following paragraphs.

1. MSU received a $920,000 grant from the U.S. Department of Education (CFDA #84.031) in 1987 for a chemical research computer network. The grant requires a 50 percent ($460,000) cost sharing by the university. The total federal share of expenditures charged to this grant are $451,171 as of October 1989. This grant is a cost reimbursable contract which provides for the university to obtain reimbursement for expenditures incurred. However, due to documentation problems from May 1987 through December 1988, this project incurred a cash deficit of $395,971.

   Included in the $395,971 is a $100,000 cash transfer to the "global computing" account. The global computing account is for a $2.4 million upgrade of the university's central computer system. During the audit, the grant files did not document the equipment acquired with this transfer nor how this transaction related to the overall scope of the approved grant proposal as required by federal regulations. Because of the documentation problems the $100,000 is a questioned cost for this grant.

In addition, as of October 1989 the university had not billed the grantor for the majority of expenditures because it could not document the cost sharing portion of the grant. Assuming the university eventually is able to document its cost sharing, and bills the grantor, lost interest on charges not billed is approximately $54,450 to date. Each month's delay in billing results in an additional $2,636 in lost interest. Until the university documents compliance with provisions of this grant, the entire $451,171 of expenditures is a questioned cost.

2. A grant from the National Science Foundation (CFDA #47.999) for $170,000 required MSU to provide matching state or private funds of $85,000 toward the purchase of research equipment. G&C officials stated they were not aware of the required match. The file did not document the matching expenditures requirement. We contacted the grantor and obtained documentation that the principal investigator of the project had approved the matching requirement in writing.

   The federal grantor in this case could disallow the $170,000 of grant expenditures based on failure to provide matching funds and adequately document matching expenditures as required by federal regulations. As noted on page 21, we also questioned the $170,000 for failure to comply with state purchasing laws.

These problems resulted from incomplete information supplied to the G&C Office by principal investigators and a lack of compliance with procedures in the G&C system for tracking matching and cost sharing expenditures. Without complete information, MSU's G&C system cannot adequately monitor spending to ensure compliance with contractual agreements and state and federal laws and regulations. Inability to provide adequate documentation of grant activity may cause federal, state, and private grantors to disallow grant expenditures, resulting in potential losses to the university and the state.

Recommendation #4

We recommend MSU:

A. Strengthen procedures to track matching and cost sharing expenditures in grant records of the Grants and Contracts Office to ensure grant requirements are met; and

B. Improve documentation of grant activity in the grant control system.

Accurate Records

The university accounting system generates automatic billings to projects for items requested or utilized by the principal investigators. We found object coding problems with Chemistry Stores automatic billings. Chemistry Stores purchases items for resale and charges departmental customers, including grant and contract projects, through MSU's automatic billing system. The information prepared by the Chemistry Stores billing clerk and input to the automated billing system did not accurately classify the type or object of expenditures for Chemistry Store transactions.

For example, one federal grant project had at least $37,565 of equipment purchased from Chemistry Stores coded as "supplies". The items included a $6,176 freezer and an $11,525 laser. In addition to the equipment purchased through Chemistry Stores, the grant records reflect an additional $4,093 of equipment purchases. The grant had no equipment budget authorized by the grantor, so the purchases were not an allowable expenditure under the grant. Therefore, we question $41,658 of equipment costs for this grant (HHS CFDA #13.867). A similar grant purchased at least $25,038 of equipment from Chemistry Stores which was reported as "supplies". The grant records reflect an additional equipment cost of $7,922. Therefore, the total equipment costs in this grant are $32,960. However, the grant award only allowed for $1,710 of equipment. We question

$31,250 of equipment costs which exceed the budget amounts for this grant (CFDA #13.867).

Misclassified or inaccurately classified costs distort grant records and result in inaccurate expenditure information being reported to the grantor. Because equipment purchases are recorded as supplies, G&C personnel said they are unable to determine the nature of many charges to grant accounts made through automatic billing procedures for Chemistry Stores. If the costs were properly classified, the G&C office could use the information to determine if the costs are allowable under the grant agreements.

In addition to misclassified costs, we noted other concerns with Chemistry Stores' transactions. The internal auditor also noted these concerns in May 1989. The function of Chemistry Stores is to obtain and provide chemicals and related supplies used by the Chemistry Department or other departments. By obtaining equipment for resale, Chemistry Stores unnecessarily duplicates a service already provided by the MSU Purchasing Department. Chemistry Stores' current method of pricing and recording equipment purchases weakens MSU's controls over spending grant moneys in compliance with grant agreements.

Chemistry Stores in some cases, adds a ten to twelve percent markup to the cost of equipment. The markup is not consistently applied to all equipment purchases made through Chemistry Stores. Out of 42 individual purchases examined, only 25 items included any markup. We determined there was a total of $2,624 in markups for the two grants discussed in the previous paragraphs (HHS CFDA #13.867). The cost of equipment items purchased through Chemistry Stores, therefore, may exceed the cost which would result if the MSU Purchasing Department provided the items. The Purchasing Department does not use markups. The internal auditor noted a need exists to develop a consistent markup policy for Chemistry Stores. Federal regulations specifically allow only actual costs and require the university to treat costs consistently. Because the markups are not actual costs and because the markups are not applied consistently, they are unallowable charges to federal grants. We could not estimate the total questioned costs to federal grants caused by the markups.

In a May 1989 report, MSU's internal auditor noted other related items concerning the Chemistry Stores' operations. Concerns noted by the internal auditor include:

1. Expenditures have consistently exceeded revenues since 1984.

2. A lack of knowledge about and use of standard business procedures in the operation of Chemistry Stores.

3. Expenditure of Chemistry Stores' funds for support and operations of the chemistry department including $72,000 of equipment for the Department.

Because of the concerns noted by the internal auditor and because Chemistry Stores duplicates certain services provided by the Purchasing Department, university management should reevaluate the role of Chemistry Stores' equipment purchases in order to improve management controls and efficiency.

Recommendation #5

We recommend MSU:

A. Review procedures to ensure automatic billings correctly classify expenditures in the accounting records.

B. Review automatic billings to grant projects to identify instances of unallowable equipment purchases or markups.

C. Charge only actual costs for equipment purchases billed to grant projects.

D. Reevaluate the role of Chemistry Stores equipment purchases.

Cash Management

The university receives grant funds through cash requests (drawdowns) and reimbursement billings. Because drawdowns and billings are predominantly on a reimbursement basis and are requested on a monthly or longer basis, the time lag between an expenditure and subsequent reimbursement requires the use of state funds. As noted in our two prior audits, MSU does not request funds from grantors often enough to ensure the most efficient use of state funds. We estimated the monthly balance of grant expenditures pending reimbursement averaged $1,250,573 during fiscal year 1987-88 and $2,081,600 during fiscal year 1988-89. The following illustrates the estimated lost investment income on state funds pending reimbursement for the last six years.

	Fiscal Year	Estimated Lost Investment Income
Current Audit	1988-89	$141,341
" "	1987-88	84,914
Prior Audits	1986-87	42,119
" "	1985-86	23,845
" "	1984-85	50,000
" "	1983-84	50,000
Six Year Total		$392,219

Source: Prepared by the Office of the Legislative Auditor

In each of our two prior audits we recommended MSU request moneys in a manner which would minimize the necessity for the state funds to advance cash to grant programs. MSU concurred with both of our prior recommendations and in response to the recommendation in our audit for the two fiscal years ended June 30, 1985, MSU changed the timing of the request for reimbursement. Previously the university's requests were made at the end of the month but prior to the payroll costs being paid.

The university altered the timing of the requests so they were made after the payroll was paid. This helped reduce the time lag and temporarily reduced the lost investment income amount as shown above. However, MSU has not fully implemented the prior cash management recommendation. Addressing the problems previously discussed on pages 6 through 14 could also lead to more timely billing on some projects and reduce the lost investment income.

Federal regulations allow the recipient to make drawdowns as close as possible to the time of making disbursements. Section 17-2-108, MCA, requires agencies to use non-General Fund moneys wherever possible before using General Fund moneys. These federal and state regulations provide for the use of frequent drawdowns in order to minimize lost investment income to the state on state funds or to the federal government on federal funds.

Grants and Contracts Office personnel said lack of sufficient personnel prohibits more frequent requests for funds in most cases. The G&C Administrator stated he plans to hire one additional staff at approximately $16,500 to $18,000 per year to alleviate the billing problem. A Student Financial Aid Office employee said he could monitor more carefully and request funds more frequently from the grantor if he chose to do so; however, he said he intentionally keeps federal cash balances low at the end of academic quarters to ensure they do not have excessive cash on hand for quarterly federal reports.

MSU could draw on grants received via wire transfer letters of credit, such as the student financial aid funds from the U.S. Department of Education, as frequently as every three days. The university should concentrate efforts for more frequent billings on high dollar grants in order to minimize the use of state funds. Such requests would more effectively minimize cash on hand while reducing negative account balances and increasing investment income for the state.

Recommendation #6

We recommend MSU monitor cash balances and request grant moneys in a manner which minimizes the necessity for the state funds to advance cash to grant programs.

Purchasing Controls

We identified several violations of university, state, and federal purchasing policies and state purchasing laws related to grant and nongrant expenditures. Management should strengthen its controls over purchasing to avoid violations of laws and policies such as those discussed in the following paragraphs.

Compliance with State Purchasing Laws

In October 1987, a university professor ordered two special purpose research instruments costing a total of $747,000. The purchase of these instruments did not go through state or university purchasing procedures as required by state law and federal regulations. Although the professor did contact and obtain proposals from several vendors, the process did not comply with the competitive, sealed bidding requirements of state law. MSU's agreement with the State Purchasing Division, Department of Administration, requires research equipment costing more than $10,000 be acquired through the State Purchasing Division. There was no approved requisition or purchase order.

University officials stated these purchases were obtained through a "use agreement" with the MSU Foundation. A "use agreement" is a funding mechanism where the university enters into a formal agreement with the Foundation to acquire equipment. The Foundation purchases the equipment and the university agrees to make periodic payments including interest to reimburse the Foundation. The agreement specifies the equipment to be purchased and the payment terms. We noted there was no formal use agreement covering these purchases.

The Foundation wrote a check to the vendor and the same day the university wrote a contingent revolving check to reimburse the Foundation. The university recorded the check to the Foundation as "rent" instead of "equipment." Because the Foundation received payment in full from MSU and paid the vendor the same day, "rent" is not the correct expenditure classification. In a May 1989 report, the internal auditor also noted this transaction ". . . is misleading, as there was coding error when . . . expenditures were coded as 'rental' rather than 'capital equipment' . . ." This is another example of the misclassification of costs, similar to instances discussed on page 15. The involvement of the Foundation does not alter the substance of the transaction as a purchase by the university. MSU officials ordered the equipment and fully paid for the equipment; therefore, the transaction was a purchase by MSU and should have followed state purchasing laws.

Circumventing state purchasing laws and misclassifying the expenditure on the accounting records constitute a significant problem which indicates the inability of MSU's current management control system to prevent or detect similar problems in the future. MSU needs to implement controls to address this problem.

Because the equipment purchases did not follow established university policies and state law, the costs are not allowable per federal regulations (OMB Circular A-21). Accordingly, we question $547,000 of equipment charges to the following federal grants:

$170,000 of a National Science Foundation grant (CFDA #47.999)

$300,000 of a Health & Human Services grant (CFDA #13.999)

$77,000 of a Department of Education grant (CFDA #84.031)

The remaining $200,000 was charged to a private grant. As discussed on page 24, the final resolution of questioned costs contained in this report will occur when the federal agencies receive the Montana Single Audit Report issued by our office.

Recommendation #7

We recommend MSU comply with state purchasing laws for equipment acquisitions.

Already Received Purchase Requisitions

We noted extensive use of "Already Received Purchase Requisitions" (ARPR) during the audit period. During a seven month period in fiscal year 1988-89, MSU processed over 1,000 ARPRs on printed forms provided for this purpose. Of approximately 400 ARPRs we reviewed, we found at least 43 cases which were obviously not emergencies. University policy permits use of ARPRs if the purchase results from a "situation or occurrence of a serious nature, developing suddenly and unexpectedly, and demanding immediate action." Many of ARPRs we reviewed did not meet that criterion. In addition, many of the ARPRs we reviewed were also explained as sole source purchases, meaning only one vendor could supply the item. State policy requires the agency to approve sole source requisitions and justifications before acquiring the items. This is not the case with ARPRs. The item is purchased and the paper work and approval is after the fact. In addition, state policy specifies that exigency purchases (i.e., emergency, requiring immediate action) shall be limited to those supplies necessary to meet the exigency and should be based on extreme need. Typical justifications for ARPR use included the following.

- Purchase of a portable lap top computer for $1,428 to finish a report by the deadline (HHS CFDA #13.867). The principal investigator justified the purchase by stating his travel expense would not have been reimbursed for a meeting he attended if the report was not submitted on time. He also explained that he traveled a lot on university business and he could make more efficient use of his time using the computer. The computer was purchased in October 1988 but the paper work was not submitted until April 1989.

- Purchase of two disc drives totaling $1,840 for part of a traveling exhibit. The exhibit was to open in July 1989. The equipment was purchased in June 1989. The justification said there was no time to obtain a purchase order. However, the file indicated that the department considered acquiring this equipment in April 1989.

- Purchase of 50 calculators for $1,019. The justification stated in order to do the demonstration right away, the calculators needed to be purchased immediately. It stated there was not time to do a purchase order. The instructor responsible for the demonstration should have been aware of her work schedule and could have avoided using an ARPR by more advance planning and anticipating project needs and time frames.

Based on our review, many of the "emergency" situations could have been avoided by planning on the part of university personnel. These and other examples indicate that ARPRs were being used to justify and document purchases which circumvented the normal purchasing procedures of the university. Improper use of ARPRs undermines MSU's purchasing control system. By allowing misuse of ARPRs for federal grant purchases, MSU violates federal procurement regulations which require the university to follow established purchasing policies. The improper purchases are questioned costs under federal regulations.

The problem of ARPR misuse was addressed in reports by the Montana Department of Administration Purchasing Division in March 1988 and by MSU's internal auditor in May 1989. We also discussed problems with sole source and emergency purchase orders in a performance audit in May 1980.

Recommendation #8

We recommend MSU management limit the use of already received purchase requisitions and exigency purchases to emergency situations as required by state policy.

Summary

As noted in the preceding sections, management controls need improvement at the university. The controls were not operating as originally designed. The questioned costs and control issues noted in this audit report which impact federal grants will be included in the next biennial Montana Single Audit Report issued by our office. As noted on the inside cover of this report, we issue a biennial statewide Single Audit Report for the state of Montana which complies with the reporting requirements of the Single Audit Act of 1984 and OMB Circular A-128. Upon receipt of the Single Audit Report, the federal agencies will make the final resolution of questioned costs. Given the seriousness of the control problems noted with the G&C system and the magnitude of the questioned costs noted in this report, future funding for federal grants could be in jeopardy. In addition, the federal resolution of questioned costs could result in MSU having to refund questioned costs to the grantors. Refunding questioned costs could impact future budgets and impair MSU's ability to maintain its level of operations.

Total expenditures processed by the G&C system and charged to federal grant projects was $8.7 million in fiscal year 1987-88 and $8.9 million in fiscal year 1988-89. Of these amounts our audit disclosed the following questioned costs:

$165,782 because MSU exceeded the project budgets. See page 7.

$451,171 because MSU did not document the required cost sharing in compliance with the grant. See page 14.

$547,000 of equipment expenditures because MSU did not comply with state purchasing laws. Of this amount, $77,000 is included in the $451,171 above. See page 21.

$16,281 because MSU did not have a grant award. See page 11.

$72,908 because the equipment expenditures are misclassified as supplies and the expenditures exceed the approved budget amounts. See page 15.

$13,352 because the items were acquired with "already received purchase requisitions" and did not comply with state purchasing laws. See pages 9 and 22.

Not all of these costs have been billed and collected from grantors. Of the total $1,189,494 questioned costs noted above, MSU had not billed or collected $578,034 as of October 1989.

Due to the significance of the control problems noted we are unable to provide assurance to the federal grantors that the university control systems are adequate to ensure compliance with terms and conditions of federal programs.

Recommendation #9

We recommend MSU management control grant and contract expenditures and ensure compliance with contractual agreements.

Museum of the Rockies

The Museum of the Rockies is a regional museum located on the MSU campus which interprets both the physical and cultural heritage of Montana and the Northern Rocky Mountain Region. The Museum offers exhibits featuring the geology, paleontology, archaeology, ethnology, history and art of the region. The museum also features a modern "state of the art" planetarium.

The Museum of the Rockies is a department of MSU. The museum director is hired by the President of MSU and reports directly to the President or Vice President for Research of the university. The museum director is responsible for the management and administration of museum operations and programs. Museum employees are under the university pay plan and receive the same employee benefits (retirement, medical, vacation, and sick leave) as other MSU employees in the appropriate categories (contract, classified, or hourly).

The museum receives support from a private non-profit corporation governed by the Board of Trustees. Under the bylaws of the nonprofit museum corporation, three of the twenty one members of the Board of Trustees are university officials. The three board members are the university President or his representative and two others designated by the President.

As a department of the university, all museum activity under control of the museum director (i.e., department head) should be reported in the university accounting records and reflected in the MSU financial statements, in order to comply with generally accepted accounting principles and state law. Currently MSU accounting records do not reflect total museum activity. For fiscal year 1988-89 MSU reports only $557,000 of revenue and expenses for museum activity. However, the museum financial statements prepared for the Board of Trustees report total revenue and support of approximately $3.6 million and expenses of $2.5 million for fiscal year 1988-89. The museum financial statements have been audited by a public accounting firm for fiscal year 1987-88 and fiscal year 1988-89.

The financial statements prepared for the Board of Trustees encompass all assets, liabilities, revenues, and expenses related to museum activities. The financial statements do not distinguish the museum activity of MSU from that of the private non-profit corporation. MSU officials need to analyze this activity and ensure the university accounting records include all museum assets, liabilities, and operations under MSU management oversight.

Recommendation #10

We recommend MSU record the museum department operations on its accounting records.

Contingent Revolving Fund

Section 17-2-201, MCA, allows the Department of Administration to authorize the establishment and use of contingent revolving funds (CRF) for specific purposes. State policy indicates that "a revolving cash account . . . is used to make disbursements where timing needs cannot be met by the state warrant system. The revolving cash account is to be used for purposes demanding immediate payment . . . Agencies should use their judgment in deciding whether a particular transaction qualifies as a minor, immediate, or emergency payment. Under normal circumstances, transactions input to SBAS will generate a warrant for mailout or pickup the next afternoon." This policy was developed in an attempt to minimize the amount of cash and related activity in nontreasury accounts, while maintaining a system to pay for items on an emergency or immediate needs basis. If the moneys are in a treasury account, the state can maximize the investment earnings on these funds.

In our prior audit we recommended MSU use the CRF account in compliance with state policy. MSU concurred with the recommendation and MSU officials noted in their response: "In November 1987, a memo was circulated to all departments advising them that the use of the contingent revolving fund must be reduced to assure compliance with state laws and policies. Substantial progress has been made in reducing the number of transactions involving the contingent revolving account during the past several months." The university reduced the use of the CRF for travel advances but this was offset by an increase in payroll transactions due to implementation problems with a new system. As discussed below, MSU still needs to improve compliance with state policy to fully implement the prior audit recommendation.

State and university policy limits CRF use to postage, shipping charges, unanticipated travel and payroll, publications that require cash orders, and invoices that require immediate payment to take advantage of cash discounts. We noted in both our current and prior audits, the university used its CRF for purposes other than those specified in state policy (i.e., did not require immediate payment or was not specifically listed in state policy). Some examples include:

1. Payments to the Endowment and Alumni Foundation.
2. Payments to vendors for past due accounts and already received purchase requisitions.
3. A reimbursement of gate receipts to an athletic association.
4. Payments to local travel agents for airline tickets.

These examples are similar to those noted in our prior report.

We analyzed the activity in the CRF for the last six months of fiscal year 1988-89. As shown below, the university still uses the CRF extensively.

Month	Amount of Checks*	Number of Checks Written*
January 1989	$637,301	772
February 1989	383,652	789
March 1989	488,940	931
April 1989	447,383	861
May 1989	480,888	748
June 1989	496,244	876

* Excludes student financial aid

The level of activity is similar to activity noted in our prior report. In the prior report we analyzed four months activity in fiscal year 1986-87. Comparing the activity above to that in our prior report provides the following:

	Current Audit Fiscal 1988-89	Prior Audit Fiscal 1986-87
Average Number of Checks/Month	829.5	830.5
Average Amount of Checks/Month	$489,068	$594,712

We noted a portion of the CRF activity is for already received purchase requisitions, payment of past due accounts, and purchase of airline tickets. As noted on pages 22 and 9, the university needs to address problems with already received purchase requisitions and late payments to vendors. University officials stated in October 1989 they would review alternatives for purchasing airline tickets. They also stated they intend to implement additional approval procedures for large individual payments. Management attention to these items could result in a significant decrease in CRF activity.

Recommendation #11

We recommend MSU use the contingent revolving account in compliance with state policy.

Appropriation Reversion

In fiscal year 1987-88 MSU personnel transferred $135,583 cash from the Unrestricted Fund appropriation to the Unexpended Plant Fund. MSU officials stated the cash was set aside for a possible match of an energy conservation grant. However, the university did not receive the grant award until the following fiscal year (November 1988).

MSU improperly recorded an expenditure in the physical plant operations account in the Unrestricted Fund and revenue in the Unexpended Plant Fund when this transaction was processed. By charging an expenditure to the physical plant operations account, MSU improperly reduced general operation appropriation authority in the Current Unrestricted Fund when, in fact, there was no expenditure obligation. Expenditures should not be recorded unless there is a valid obligation and related liability incurred. As of September 1989 the $135,583 cash remained in the Unexpended Plant Fund.

The expenditure charge directly impacts the amount of appropriation remaining in the calculation of the fiscal year 1987-88 General Fund reversion. The $135,538 cash represents unexpended General Fund appropriation authority. State law (section 17-7-304, MCA) requires reversion of any unexpended appropriation balance. In addition, state law (section 17-2-108, MCA) also requires expenditure of non-General Fund money first. Because the original appropriation period has expired any remaining unexpended cash should be returned to the General Fund in compliance with state law.

In a similar instance, during fiscal year 1988-89, MSU remodeled and converted an unoccupied dormitory into office space. The university administration entered into a formal agreement to provide $150,000 cash from Auxiliary operations to fund the project.

During the fiscal year end closing period university officials transferred $71,525 of expenses for this project out of the Plant Fund to the Current Unrestricted Fund, thereby reducing the Current Unrestricted appropriation balance. In effect, MSU transferred cash from the Unrestricted Fund to the Plant Fund to restore cash previously used for the renovation project. University officials stated the Unrestricted Fund absorbed a portion of the renovation expenses because the Unrestricted Fund would have spent considerable amounts maintaining two old buildings that housed some of the operations which moved into the renovated space. Officials stated the expenses paid by the Unrestricted Fund were "cost savings" realized by the renovation project and therefore were properly charged to the Unrestricted Fund. This rational is not valid because university officials knew at the beginning of the year who would occupy the renovated space when they initially provided the $150,000 to finance the project. Also, "cost savings" are not a valid obligation or expenditure and therefore should not reduce the Unrestricted Fund appropriation. State law mandates that an agency shall spend non-General Fund money first. By restoring unexpended cash in the Plant Fund and recording expenditures in the Unrestricted Fund, the university failed to comply with state law. The $71,525 represents cash that otherwise would have been available for reversion to the General Fund.

Recommendation #12

We recommend MSU:

A. Return $207,063 to the General Fund.

B. Comply with section 17-2-108, MCA, and use non-General Fund money first.

C. Record expenditures only when a valid obligation exists.

Accounting Issues

The following report sections detail items where MSU financial administration did not detect errors on the university's accounting system.

Recording Revenue in the Proper Fund

We found two instances where the university recorded revenue in the wrong fund.

1. Revenue received on "fixed price" contracts above the costs (profits) associated with the performance of the contract should be recorded in the unrestricted fund. MSU leaves the excess money in the Restricted Fund where the revenue is initially recorded. When the funds are no longer restricted by an outside source, any profits should be accounted for in the Unrestricted Operating or Designated Fund. We estimate a total of not more than $60,000 is recorded in the wrong fund.

The issue of fixed price contract profits being recorded in the wrong fund was addressed in the previous audit. MSU did not concur with the prior audit recommendation. MSU personnel expressed concern that if the remaining funds are moved out of the Restricted Fund it may reduce the incentive for principal investigators to complete projects in an efficient manner. Recording the profits in the unrestricted accounts would improve the university's reporting in compliance with generally accepted accounting principles, while maintaining management's incentives for efficiency and flexibility.

2. In fiscal year 1988-89 the Pell grant (CFDA #84.063) administrative cost allowance of $18,415 was recorded as revenue in the Restricted Fund. The administrative cost allowance is given to the university based on a flat fee of five dollars per Pell grant application. The university can use the money at its discretion to support its operations. Generally accepted accounting principles (GAAP) requires the administrative cost allowance be recorded in the Current Unrestricted Operating Fund. MSU officials stated the wrong account number was used when making the deposit.

Recommendation #13

We recommend MSU record profits from fixed price contracts and administrative cost allowances in the Unrestricted Fund.

Use Agreements

Over the years MSU has entered into use agreements with the MSU Foundation. The Foundation purchased equipment items that MSU departments needed for classroom and research projects. The departments were required to make periodic payments to the Foundation for the use of the equipment. When payments were complete the Foundation would transfer title of the equipment to the university.

The use agreements are not correctly accounted for on the university's property and accounting system. As discussed on page 21, the university improperly recorded the payments as "rent" instead of "equipment." Equipment purchased through the Foundation should not be recorded as rent expense. Under state policy and generally accepted accounting principles, the substance of the use agreements meets the criteria for classification as a capital lease. Capital leases should be accounted for as follows:

1. Capitalize the equipment at the inception of the lease.

2. Establish the liability (lease payable) for the debt.

3. Reduce the lease payable balance after each periodic payment.

At June 30, 1989 approximately $80,160 of liability remains on two outstanding use agreements. This liability is not recorded on the accounting records. MSU personnel indicated they were considering alternate methods of acquiring equipment in the future rather than use agreements with the Foundation. If MSU does enter into any future use agreements, the acquisitions should be accounted for as capital leases.

Recommendation #14

We recommend MSU account for capital leases in accordance with generally accepted accounting principles.

Recording Expenditures in the Proper Year

Three equipment purchases received after June 30, 1988, were recorded as prior year expenditures when the invoices were paid. MSU personnel indicated that they used prior year expenditures because the invoices for the items were dated before June 30th. Under state policy the controlling factor in determining which fiscal year an expenditure should be recorded is the date of the purchase orders or the date the items are received, not the invoice date. MSU had not issued any purchase orders for these items as of June 30, 1988. Officials stated MSU does not have a system to document the date goods or services are received. A total of $229,479 of expenditures were incorrectly charged as prior year expenditures.

Recommendation #15

We recommend MSU record expenditures in the proper year in compliance with state accounting policy.

Independent Auditor's Report & MSU Financial Statements

Summary of Independent Auditor's Report

Summary of Independent Auditor's Report

The auditor's opinions issued on Montana State University, Agriculture Experiment Station and Extension Service are intended to convey to the reader of the financial statements the degree of reliance which can be placed on the amounts presented. The reader may rely on the fairness of the amounts presented for Montana State University in the statements shown on pages 38 through 53.

The reader may rely on the fairness of the amounts presented for the Agriculture Experiment Station in the statements shown on pages 57 through 65.

The reader may rely on the fairness of the amounts presented for the Extension Service in the statements shown on pages 70 through 78.

STATE OF MONTANA

Office of the Legislative Auditor

STATE CAPITOL
HELENA, MONTANA 59620
406/444-3122

LEGISLATIVE AUDITOR:
SCOTT A. SEACAT

LEGAL COUNSEL:
JOHN W. NORTHEY

DEPUTY LEGISLATIVE AUDITORS:

MARY BRYSON
Operations and EDP Audit

JAMES GILLETT
Financial-Compliance Audit

JIM PELLEGRINI
Performance Audit

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Balance Sheet of Montana State University as of June 30, 1989, and the related Statements of Changes in Fund Balances and the Statements of Current Funds Revenues, Expenditures, and Other Changes for each of the two fiscal years ended June 30, 1989. These financial statements are the responsibility of Montana State University management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Montana State University as of June 30, 1989, and the changes in its fund balances and the current funds revenues, expenditures, and other changes for each of the two fiscal years then ended in conformity with generally accepted accounting principles.

Respectfully submitted,

James Gillett

James Gillett, CPA
Deputy Legislative Auditor

September 20, 1989

MONTANA STATE UNIVERSITY
BALANCE SHEET
June 30, 1989

ASSETS

CURRENT FUNDS:	
Unrestricted:	
General operating:	
Cash	$ 1,476,926
Accounts receivable	342,254
Due from other fund groups	2,984,859
Total general operating	4,804,039
Designated:	
Cash	905,191
Accounts receivable	271,577
Due from other fund groups	397,722
Investments (Note 3)	102,800
Inventories	481,541
Total designated	2,158,831
Auxiliary enterprises:	
Cash	680,851
Accounts receivable	20,114
Due from other fund groups	42,001
Investments (Note 3)	2,481,500
Inventories	322,752
Total auxiliary enterprises	3,547,218
Total unrestricted	10,510,088
Restricted:	
Cash	925,263
Accounts receivable	1,839,505
Due from other fund groups	13,774
Investments (Note 3)	473,923
Total restricted	3,252,465
Total current funds	$13,762,553
STUDENT LOAN FUNDS:	
Cash	$ 102,058
Loan receivable - less allowance for bad debts	9,351,273
Accounts receivable	2,477
Investments (Note 3)	77,000
Total student loan funds	$ 9,532,808

MONTANA STATE UNIVERSITY
Balance Sheet (Cont.)

LIABILITIES AND FUND BALANCES

CURRENT FUNDS		
Unrestricted:		
General operating:		
Accrued payroll		$ 2,639,735
Accounts payable and accrued liabilities		197,979
Due to other fund groups		947,271
Deposits		29,959
Deferred revenue		472,887
Compensated absences payable (Note 7)		3,704,828
Fund balance (Note 1)		(3,188,620)
Total general operating		4,804,039
Designated:		
Accrued payroll		379,667
Accounts payable and accrued liabilities		416,261
Due to other fund groups		179,075
Compensated absences payable (Note 7)		834,092
Fund balance (Note 1)		349,736
Total designated		2,158,831
Auxiliary enterprises:		
Accrued payroll		337,316
Accounts payable and accrued liabilities		124,249
Deposits		245,942
Deferred revenue		34,263
Due to other fund groups		188,126
Compensated absences payable (Note 7)		356,685
Fund balance		2,260,637
Total auxiliary enterprises		3,547,218
Total unrestricted		10,510,088
Restricted:		
Accrued payroll		602,019
Accounts payable and accrued liabilities		56,652
Due to other fund groups		2,790,963
Fund balance		(197,169)
Total restricted		3,252,465
Total current funds		$13,762,553
STUDENT LOAN FUNDS:		
Accounts payable and accrued liabilities		$ 41,044
Fund balances:		
U.S. Government grants refundable	$8,483,671	
University funds	942,630	
Private gifts	65,463	9,491,764
Total student loan funds		$ 9,532,808

MONTANA STATE UNIVERSITY
BALANCE SHEET
June 30, 1989

ASSETS

ENDOWMENT FUNDS:	
Cash	$ 1,195
Accounts receivable	91
Investments (Note 3)	593,200
Total endowment funds	$ 594,486
PLANT FUNDS:	
Unexpended:	
Cash	$ 1,249,891
Accounts receivable	14,735
Due from other fund groups	103,337
Investments (Note 3)	1,296,257
Construction advances to state	81,307
Total unexpended	2,745,527
Renewals and replacements:	
Cash	292,769
Due from other fund groups	3,122
Investments (Note 3)	405,500
Total renewals and replacements	701,391
Retirement of indebtedness:	
Cash	1,312,779
Accounts receivable	492,628
Due from other fund groups	425
Investments (Note 3)	5,541,356
Total retirement of indebtedness	7,347,188
Investment in plant:	
Land and land improvements	2,761,548
Buildings (including construction in progress)	97,225,148
Equipment	34,699,967
Livestock	102,900
Library books	18,222,624
Total investment in plant	153,012,187
Total plant funds	$163,806,293
AGENCY FUNDS:	
Cash	$ 272,502
Accounts receivable	220,411
Due from other fund groups	2,349,450
Investments (Note 3)	297,900
Total agency funds	$ 3,140,263

MONTANA STATE UNIVERSITY
Balance Sheet (Cont.)

LIABILITIES AND FUND BALANCES

ENDOWMENT FUNDS:	
Fund balance	$ 594,486
Total endowment funds	$ 594,486
PLANT FUNDS:	
Unexpended:	
Accounts payable and accrued expenditures	$ 155,454
Due to other fund groups	152,655
Bonds payable (Note 4)	1,130,632
Fund balance	1,306,786
Total unexpended	2,745,527
Renewals and replacements:	
Accounts payable and accrued expenditures	9,975
Due from other fund groups	16,289
Fund balance	675,127
Total renewals and replacements	701,391
Retirement of indebtedness:	
Accounts payable and accrued expenditures	444,820
Due to other fund groups	11,264
Fund balance	6,891,104
Total retirement of indebtedness	7,347,188
Investment in plant:	
Bonds payable (Note 4)	40,984,368
Other payables: leases	137,702
Net investment in plant	111,890,117
Total investment in plant	153,012,187
Total plant funds	$163,806,293
AGENCY FUNDS:	
Accrued payroll	$ 14,039
Accounts payable and accrued liabilities	2,092,665
Due to other fund groups	330,901
Deposits held in custody for others	702,658
Total agency funds	$ 3,140,263

MONTANA STATE UNIVERSITY
STATEMENT OF CHANGES IN FUND BALANCES
YEAR ENDED JUNE 30, 1989

	Current Funds						Plant Funds			
	Unrestricted									
	General Operating	Designated	Auxiliary Enterprises	Restricted	Loan Funds	Endowment and Similar Funds	Unexpended	Renewals and Replacements	Retirement of Indebtedness	Investment in Plant
Revenue and other additions										
Current funds revenue	$43,829,934	$8,665,530	$12,750,778	$17,687,635	-	-	-	-	-	-
Federal capital contribution		-	-	-	$ 348,984			-	-	-
University capital contribution		-	-	-	26,001		-	-	-	-
Private capital contribution		-	-	-	1,000	$ 267	$ 1,300	-	-	-
Interest on loans receivable		-	-	-	214,989	-	-	-	-	-
Student fees		-	-	-	-	-	340,630	-	$1,024,288	-
Investment income		-	-	-	6,164	953	247,913	$ 25,971	572,545	-
Endowment income & grants (Note 2)		-	-	-	-	-	-	-	595,013	-
Debt retirement (Note 5)		-	-	-	-	-	-	-	-	$ 600,000
Expended for plant facilities (including $4,351,690 charged to current funds)		-	-	-	-		-	-	-	6,943,304
Activities rental income	-	-	-	-	-		-	3,392	505,025	-
Other	-	-	-	-	3,523	-	-	-	358,559	-
Total revenue and other additions	43,829,934	8,685,530	12,750,778	17,687,635	600,661	1,220	589,843	29,363	3,055,430	7,543,304
Expenditures and other deductions.										
Current funds expenditures	43,736,829	8,091,706	10,236,954	18,447,409	-	-	-	-	-	-
Loan cancellations	-	-	-	-	31,702	-	-	-	-	-
Refunded to grantors	-	-	-	-	539	-	-	-	-	-
Provision for bad debts	-	-	-	-	2,443	-	-	-	-	-
Assigned loans	-	-	-	-	76,099	-	-	-	-	-
Expended for plant facilities (including $1,091,685 non-capital expenditures)	-	-	-	-		-	902,445	729,033	-	
Debt retirement (Note 5)	-	-	-	-		-	-	-	600,000	
Interest on debt	-	-	-	-		-	-	-	3,138,767	
Transfer of bond liability	-	-	-	-	-	-	100,580	-	-	2,270,119
Leases	-	-	-	-		-	-	-	-	52,725
Other (Note 5)	-	-	-	-	66	-	-	-	57,378	-
Total expenditures and other deductions	43,736,829	8,091,706	10,236,954	18,447,409	110,849	-	1,003,025	729,033	3,796,145	2,322,844

See notes to financial statements

MONTANA STATE UNIVERSITY
STATEMENT OF CHANGES IN FUND BALANCES (Continued)
YEAR ENDED JUNE 30, 1989

	Current Funds						Plant Funds			
	Unrestricted									
	General Operating	Designated	Auxiliary Enterprises	Restricted	Loan Funds	Endowment and Similar Funds	Unexpended	Renewals and Replacements	Retirement of Indebtedness	Investment in Plant
Transfers amount funds additions (deductions):										
Mandatory:										
All fund groups	$ (14,855)	-	$(2,050,000)	-	$ 14,855		$ (149,655)	$ 954,000	$1,245,655	-
Voluntary.										
Designated-net	-	-	-	-	-	-	(5,919)	-	(300,131)	-
Auxiliary enterprises-net	-	-	-	-	-	-	100,000	40,000	(50,000)	-
Unexpended plant-net	-	5,919	(100,000)	-	-	-	-	(113,893)	(303,345)	-
Repair and replacement-net	-	-	(40,000)	-	-	-	113,893	-	-	-
Retirement of debt-net	-	300,131	50,000	-	-	-	303,345	-	-	-
Total transfers	(14,855)	306,050	(2,140,000)	-	14,855	-	361,664	880,107	592,179	-
Net increase (decrease) in fund balance	78,250	879,874	373,824	$ (759,774)	504,667	$ 1,220	(51,518)	180,437	(148,536)	$ 5,220,460
Fund balances at beginning of year as previously reported	(2,701,701)	(918,089)	1,967,341	701,209	8,998,448	593,266	(3,819,294)	495,230	7,039,824	117,227,253
Adjustments: (Notes 1 & 7)										
Prior year revenues	(321)	399,950	(2,131)	(111,006)	-	-	(96)	-	(184)	-
Prior year expenditures	(300,458)	41,209	(59,830)	(27,598)	(11,351)	-	(224,256)	(540)	-	-
Compensated absences payable	(264,390)	(53,208)	(18,567)	-	-	-	-	-	-	-
Changes in capitalization level	-	-	-	-	-	-	-	-	-	(4,203,782)
Other (Note 1)	-	-	-	-	-	-	5,401,950	-	-	(6,353,814)
Total adjustments	(565,169)	387,951	(80,528)	(138,604)	(11,351)	-	5 177,598	(540)	(184)	(10,557,596)
Fund balances at beginning of year as adjusted	(3,266,870)	(530,138)	1,886,813	562,605	8,987,097	593,266	1 358,304	494,690	7,039,640	106,669,657
Fund balances at end of year	$(3,188,620)	$ 349,736	$ 2 260,637	$ (197,169)	$9,491,764	$594,486	$1,306,786	$ 675,127	$6,891,104	$111,890,117

See notes to financial statements.

MONTANA STATE UNIVERSITY
STATEMENT OF CHANGES IN FUND BALANCES
YEAR ENDED JUNE 30, 1988

	Current Funds						Plant Funds			
	Unrestricted									
	General Operating	Designated	Auxiliary Enterprises	Restricted	Loan Funds	Endowment and Similar Funds	Unexpended	Renewals and Replacements	Retirement of Indebtedness	Investment in Plant
Revenue and other additions:										
Current funds revenue.	$44,127,148	$14,530,775	$11,923,572	$16,976,703	-	-	-	-	-	-
Federal capital contribution	-	-	-	-	$ 147,057	-	-	-	-	-
University capital contribution	-	-	-	-	6,950	-	-	-	-	-
Private capital contribution	-	-	-	-	335	$ 554	-	-	-	-
Interest on loans receivable	-	-	-	-	184,638	-	-	-	-	-
Student fees	-	-	-	-	-	-	$ 337,444	-	$1,004,284	-
Investment income	-	-	-	-	10,125	725	380,593	$ 51,938	513,309	-
Endowment income & grants (Note 2)	-	-	-	-	-	-	-	-	603,687	-
Debt retirement (Note 5)	-	-	-	-	-	-	-	-	-	$ 778,750
Transfer of bond liability	-	-	-	-	-	-	3,779,913	767,252	-	-
Expended for plant facilities (including $4,447,615 charged to current funds)	-	-	-	-	-	-	-	-	-	9,149,859
State appropriations	-	-	-	-	-	-	379,743	-	-	-
Other	-	-	-	-	-	-	127,675	5,033	533,507	-
Total revenue and other additions	44,127,148	14,530,775	11,923,572	16,976,703	349,105	1,279	5,005,368	824,221	2,654,787	9,928,609
Expenditures and other deductions:										
Current funds expenditures	43,191,199	14,560,542	9,713,840	17,068,335		-	-	-	-	-
Loan cancellations	-	-	-	-	53,735	-	-	-	-	-
Refunded to grantors	-	-	-	-	1,425	-	-	-	-	-
Administrative expenditures		-	-	-	64,978	-	-	-	-	-
Provision for bad debts	-	-	-	-	(343,770)	-	-	-	-	-
Expended for plant facilities (including $116,308 non-capital expenditures)	-	-	-	-	-	-	4,806,447	491,871	-	-
Debt retirement (Note 5)		-	-	-	-	-	-	-	778,750	-
Interest on debt		-	-	-	-	-	-	-	3,188,870	-
Transfer of bond liability	-	-	-	-	-	-	-	-	-	4,547,165
Leases	-	-	-	-	-	-	-	-	-	84,977
Other (Note 5)	-	-	-	-	-	-	-	-	46,300	
Total expenditures and other deductions	43,191,199	14,560,542	9,713,840	17,068,335	(223,632)	-	4,806,447	491,871	4,013,920	4,632,142

See notes to financial statements.

MONTANA STATE UNIVERSITY
STATEMENT OF CHANGES IN FUND BALANCES (Continued)
YEAR ENDED JUNE 30, 1988

	Current Funds						Plant Funds			
	Unrestricted									
	General Operating	Designated	Auxiliary Enterprises	Restricted	Loan Funds	Endowment and Similar Funds	Unexpended	Renewals and Replacements	Retirement of Indebtedness	Investment in Plant
nsfers amount funds - additions										
leductions):										
ndatory:										
ll fund groups		$ (228,205)	$(2,000,000)	-	-	-	$ (205,008)	-	$2,433,213	-
luntary										
eneral operating-net	-	-	-	-	-	-	135,583	-	-	-
esignated net		-	-	-	-	-	(32,638)	-	-	-
uxiliary enterprises-net	-	-	-	-	-	-	12,878	$ 20,000	235,000	-
nexpended plant net	-	32,638	(12,878)	-	-	-	-	24,695	(227,935)	-
epair and replacement-net	-	-	(20,000)	-	-	-	(24,695)	-	-	-
etirement of debt net	$ (135,583)	-	(235,000)	-	-	-	227,935	-	-	-
Total transfers	(135,583)	(195,567)	(2,267,878)	-	-	-	114,055	44,695	2,440,278	-
increase (decrease) in										
nd balance	800,366	(225,334)	(58,146)	$ (91,632)	$ 572,737	$ 1,279	312,976	377,045	1,081,145	$ 5,296,467
d balances at beginning of										
ear as previously reported	(3,201,707)	(383,308)	2,040,973	724,285	8,426,009	592,009	(4,201,073)	143,898	5,957,835	113,905,620
ustments. (Notes 1 & 7)										
rior year revenues	12,638	1,560	(13,677)	(27,609)	(489)	(22)	43,209	(3,603)	(6,044)	-
rior year expenditures	(209,793)	130,738	(16,457)	(183,614)	191		25,094	(22,110)	6,888	-
ompensated absences payable	(103,205)	(484,613)	14,648	314,892	-	-	500	-	-	-
ther	-	42,868	-	(35,113)	-	-	-	-	-	(1,974,834)
Total adjustments	(300,560)	(309,447)	(15,486)	68,556	(298)	(22)	68,803	(25,713)	844	(1,974,834)
d balances at beginning of										
ear as adjusted	(3,502,067)	(692,755)	2,025,487	792,841	8,425,711	591,987	(4,132,270)	118,185	5,958,679	111,930,786
d balances at end of year	$(2,701,701)	$ (918,089)	$ 1,967,341	$ 701,209	$8,998,448	$593,266	$(3,819,794)	$495,230	$7,039,824	$117,227,253

notes to financial statements.

MONTANA STATE UNIVERSITY
STATEMENT OF CURRENT FUNDS REVENUES, EXPENDITURES, AND OTHER CHANGES
YEAR ENDED JUNE 30, 1989

	Unrestricted				
	General Operating	Designated	Auxiliary Enterprises	Restricted	Total
Revenues:					
Tuition and fees	$ 9,921,748	-	-	$ 18,652	$ 9,940,400
Federal appropriations	50,000	-	-	-	50,000
State appropriations	32,762,631	-		-	32,762,631
Federal grants and contracts	696,708	-	-	12,044,575	12,741,283
State grants and contracts	89,732	-	-	1,496,558	1,586,290
Private gifts, grants, and contracts	102,123	-	-	4,852,659	4,954,782
Endowment income	-	-	-	32,184	32,184
Other sources	206,992	-	-	2,781	209,773
Sales and service	-	$8,665,530	$12,750,778	-	21,416,308
Total revenue	43,829,934	8,665,530	12,750,778	18,447,409	83,693,651
Expenditures and mandatory transfers					
Education and general					
Instruction	23,452,146	-	-	262,616	23,714,762
Research	550,680	-	-	7,112,051	7,662,731
Public service	10,399		-	3,159,417	3,169,816
Academic support	5,146,807		-	229,593	5,376,400
Student services	4,047,197	-	-	260,688	4,307,885
Institutional support	3,799,823	-	-	419,651	4,219,474
Operation and maintenance of plant	5,617,693	-	-	19,306	5,636,999
Scholarships and fellowships	1,112,084	-	-	6,841,478	7,953,562
Other	-	-	-	142,609	142,609
Education and general expenditures	43,736,829	-	-	18,447,409	62,184,238
Designated and auxiliary enterprises					
Expenditures	-	8,091,706	10,236,954	-	18,328,660
Mandatory transfers	-	-	2,050,000	-	2,050,000
Total designated and auxiliary	-	8,091,706	12,286,954	-	20,378,660
Total expenditures and mandatory transfers	43,736,829	8,091,706	12,286,954	18,447,409	62,562,898
Other transfers and additions (deductions):					
Excess of restricted receipts over transfers to revenue	-	-	-	(759,774)	(759,774)
Transfers	(14,855)	306,050	(90,000)	-	201,195
Net increase (decrease) in fund balance	$ 78,250	$ 879,874	$ 373,824	$ (759,774)	$ 572,174

See notes to financial statements

MONTANA STATE UNIVERSITY
STATEMENT OF CURRENT FUNDS REVENUES, EXPENDITURES, AND OTHER CHANGES
YEAR ENDED JUNE 30, 1988

	Unrestricted				
	General Operating	Designated	Auxiliary Enterprises	Restricted	Total
Revenues:					
Tuition and fees	$ 9,931,369	-	-	$ 3,721	$ 9,935,090
Federal appropriations	50,000	-	-	-	50,000
State appropriations	33,159,704	-	-	-	33,159,704
Federal grants and contracts	681,406	-	-	11,500,826	12,182,232
State grants and contracts	43,500	-	-	1,198,128	1,241,628
Private gifts, grants, and contracts	131,500	-	-	4,336,117	4,467,617
Endowment income	-	-	-	26,209	26,209
Other sources	129,869		-	3,334	133,003
Sales and service	-	$14,530,775	$11,923,572	-	26,454,347
Total revenue	44,127,148	14,530,775	11,923,572	17,068,335	87,649,830
Expenditures and mandatory transfers:					
Education and general					
Instruction	23,910,139	-	-	478,355	24,388,494
Research	600,545	-	-	6,323,025	6,923,570
Public Service	11,876	-	-	2,684,485	2,696,361
Academic support	5,700,255	-	-	168,182	5,868,437
Student services	3,945,384	-	-	194,783	4,140,167
Institutional support	3,165,445		-	1,247,438	4,412,883
Operation and maintenance of plant	4,787,099	-	-	107,737	4,894,836
Scholarships and fellowships	1,070,456	-	-	5,629,873	6,700,329
Other	-	-	-	234,457	234,457
Education and general expenditures	43,191,199	-		17,068,335	60,259,534
Designated and auxiliary enterprises:					
Expenditures	-	14,560,542	9,713,840		24,274,382
Mandatory transfers	-	228,205	2,000,000		2,228,205
Total designated and auxiliary	-	14,788,747	11,713,840	-	26,502,587
Total expenditures and mandatory transfers	43,191,199	14,788,747	11,713,840	17,068,335	86,762,121
Other transfers and additions (deductions):					
Excess of transfers to revenue over restricted receipts	-	-	-	(91,632)	(91,632)
Transfers	(135,583)	32,638	(267,878)	-	(370,823)
Net increase (decrease) in fund balance	$ 800,366	$ (225,334)	$ (58,146)	$ (91,632)	$ 425,254

See notes to financial statements

MONTANA STATE UNIVERSITY

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 1989

1. Summary of significant accounting policies

Related parties:

Montana State University, Montana Agricultural Experiment Station, and Montana Extension Service are related through common management and control; however, they are separate and distinct agencies and they receive separate federal and state appropriations. These agencies have certain related-party transactions, including sharing office facilities, management, accounting and office services. The accounts of Montana Agricultural Experiment Station and Montana Extension Service have not been included in the accompanying financial statements.

Financial statements:

The accompanying financial statements have been prepared on the accrual basis in accordance with generally accepted accounting principles for colleges and universities except as noted hereafter.

The statement of current funds revenues, expenditures, and other changes is a statement of financial activities of current funds related to the current reporting period and does not purport to present the results of operations or the net income or loss for the period.

Fund balance for unrestricted general operating funds includes $416,733 allocated for encumbrances and the unfunded liability of $3,704,828 for compensated absences payable.

Fund accounting:

The accounts of the University are maintained in accordance with the principles of fund accounting wherein resources are classified for accounting purposes into funds that are identified by the limitations and restrictions placed upon their use. Separate accounts are maintained for each fund; however, accounts with common characteristics are combined into fund groups and reflected as such in the accompanying financial statements. The common characteristics of the funds contained in the various fund groups are as follows:

Current funds:

The current funds group includes economic resources expendable in performing the primary objectives of the University, i.e., Instruction, Research and Public Service. The current funds group has two basic distinct sub-groups: unrestricted funds which have no expenditure restrictions, and restricted funds which have expenditure restrictions. Unrestricted current funds are comprised of the following:

General Operating - utilized for general operations in performing the primary objectives of the University.

Designated - utilized for educational related service activities; these funds are separately classified in order to accumulate and distinguish the costs of specialized service function areas.

Auxiliary Enterprises - utilized in providing essential on-campus services primarily to students, faculty, and staff.

Student loan funds:

The resources from this group of funds are available to students to aid in financing their education. Funds for the loans are provided by private and University sources with the majority of the funds being provided by the Federal Government.

Endowment funds:

Endowment funds are funds with specific restrictions negating the expenditure of the principal. Generally, the principal is to be maintained in perpetuity and invested for the purpose of producing income.

Plant funds:

Plant funds are separated into four distinct self-balancing sub-group accounts:

Unexpended plant - utilized for acquisition of long-term institutional assets.

Renewal and replacement - utilized for long-term institutional asset maintenance.

Retirement of indebtedness - utilized for interest and debt retirement.

Investment in plant - denotes the cost of long-term institutional assets and related liabilities.

Inventories:

Inventories, which consist mainly of food and operating supplies, are valued at cost (first-in, first-out method).

Investments:

Investments are carried at cost, which approximate market value at June 30, 1989.

Plant and equipment:

At June 30, 1989, investment in plant was adjusted $5,155,646 to reflect the totals in the property control subsidiaries. Livestock is carried at current market value with any difference from the prior year values recorded in the plant fund. Effective July 1, 1988 the equipment capitalization level increased from $200 to $500.

Depreciation:

No provision has been made for depreciation of plant facilities in accordance with generally accepted accounting principles for colleges and universities.

Allowances for bad debts:

Except for Deferred Fee Payment Plan entity in the Loan Fund, an allowance for bad debts has not been recorded. Losses from bad debts in other funds are recorded as adjustments to revenue in the year in which they are deemed uncollectible.

Allocated for encumbrances:

The University records encumbrances of general operating funds as expenditures in conformance with the Statewide Budgeting and Accounting System.

At June 30, 1989, the University had encumbered $416,733 of general operating funds that are not included in expenditures in the accompanying financial statements. The accrual basis of accounting provides that expenditures include only amounts associated with goods and services received and that liabilities include only the unpaid amounts associated with such transactions.

Unearned tuition and fees:

Summer school tuition and fee revenues are deferred at June 30 and recorded as revenue in the succeeding fiscal year.

2. Endowment funds - land grants

Montana State University benefits from two separate land grants. The first granted 90,000 acres for the University under provisions of the Morrill Act of 1862 and the second, under the Enabling Act of 1889, granted an additional 50,000 acres for the University.

Under provisions of both grants, income from the sale of land and land assets must be reinvested and constitutes, along with the balance of the unsold land, a perpetual endowment fund. The state of Montana, Board of Land Commissioners, administers both grants and holds all assets.

Investment income from the first and second grant is currently pledged to the retirement of indenture revenue bonds and is reported as revenue in the retirement of indebtedness fund.

3. Investments

Investments at June 30, 1989 consist of the following:

	Cost
State of Montana short-term investment pool	$ 4,821,023
U.S. Treasury securities, held by trustees in the entity's name	6,448,413
	$11,269,436

The investments at June 30, 1989 are owned by the following funds:

Current funds:	
Designated	$ 102,800
Auxiliary enterprises	2,481,500
Restricted	473,923
Loan funds	77,000
Endowment funds	593,200
Plant funds:	
Unexpended plant	1,296,257
Renewals and replacements	405,500
Retirement of indebtedness	5,541,356
Agency	297,900
	$11,269,436

4. Bonds payable

Revenue Bonds payable at June 30, 1989 with annual principal payments and interest rates, are as follows:

	1985 B		1986 A		1987 A		Total Amount Payment
1990	$ 500,000	7.00%	$ -0-		$ 135,000	5.90%	$ 635,000
1991	540,000	7.25	-0-		140,000	6.10	680,000
1992	580,000	7.50	-0-		155,000	6.30	735,000
1993	625,000	7.75	-0-		170,000	6.50	795,000
1994	680,000	8.00	110,000	6.60%	170,000	6.65	960,000
1995 - 2009	2,280,000	8.25- 8.65	34,725,000	6.75- 7.40	1,305,000	6.80- 8.00	38,310,000
	$5,205,000		$34,835,000		$2,075,000		$42,115,000

5. Debts refunded, issued, and escrowed

Issuance of November 1, 1985 Series B Indenture:

An original issue of $6,530,000 dated November 1, 1985 consisting of fully registered bonds without coupons, 5.50 percent to 8.65 percent, principal maturing serially on November 15, 1986 through 1996, for the addition of 63,600 square feet to the Museum of the Rockies, including facilities for a planetarium, art collection, exhibits, auditoriums, classrooms, offices, storage, and preparation areas.

Issuance of August 15, 1986 Series A Indenture:

An original issue of $34,835,000 dated August 15, 1986 consisting of fully registered bonds without coupons, 6.6 percent to 7.40 percent, principal maturing serially on November 15, 1993 through 2009, for the refunding of all bonds outstanding under the October 1, 1985 and September 1, 1985 Indentures.

Issuance of June 15, 1987 Indenture:

An original issue of $2,325,000 dated June 15, 1987 consisting of fully registered bonds without coupons, 5.10 percent to 8.00 percent, principal maturing serially on January 1, 1988 through 2003, for the acquisition, construction, repair, remodeling, replacement, renovation, improvement, furnishing, and equipping of new and existing facilities at the University.

6. Retirement plans

Eligible employees of the University are members of the Montana Public Employees Retirement System, Montana Teacher's Retirement System or TIAA/CREF Optional Retirement Plan. These plans were determined to be actuarially sound by the most recent biennial valuations. The University contributions to these plans were approximately $2,707,000 for fiscal year 1987-88 and $2,650,000 for fiscal year 1988-89.

7. Commitments and contingencies

Compensated absences payable:

As of December 31 of each year, employees can accumulate vacation leave up to twice the number of leave days earned annually and sick leave can be accumulated without limitation. Upon termination, the employee is paid the accumulated vacation leave and 25 percent of the accumulated sick leave. Vacation and sick leave payments are recorded as an expenditure at the time they are paid to the employee.

Due to system limitations, the change in the compensated absences payable amount is stated as an adjustment and not identified with the fiscal period earned or utilized by the employee.

Capital projects:

As of June 30, 1989, the University has initiated construction on the following major capital projects:

Project	Authorized	as of 6/30/89
Museum indenture project	$ 6,200,000	$ 6,156,080
Controlled environmental facility	5,302,000	5,300,985
1984B on campus living construction	4,592,000	3,046,368
Culbertson renovation	150,000	96,211
	$16,244,000	$14,599,644

Leases:

The University reserves the right to limit the amount of expenditures associated with lease contracts without penalty when, in the sole judgment of the University, annual funding or program changes necessitate. Capital lease agreements for various purposes and time periods total $137,702 at June 30, 1989. The annual payments are:

Fiscal Year	Principal	Interest	Total
1989-90	$ 57,367	$ 3,096	$ 60,463
1990-91	40,562	3,096	43,658
1991-92	23,365	3,096	26,461
1992-93	5,830	1,290	7,120
Total	$127,124	$10,578	$137,702

8. Student FTE

MONTANA STATE UNIVERSITY
SCHEDULE OF FULL-TIME EQUIVALENT (FTE) STUDENTS
FOR THE TWO YEARS ENDING JUNE 30, 1989

Quarter	Year	Undergraduate FTEs Reported[1]	Graduate FTEs Reported[2]	Total FTEs [3]
Summer	1987	953	430	1,383
Autumn	1987	8,663	490	9,153
Winter	1988	8,624	486	9,110
Spring	1988	7,743	488	8,231
Summer	1988	918	375	1,293
Autumn	1988	8,811	478	9,289
Winter	1989	8,627	514	9,141
Spring	1989	7,940	501	8,441
Annual[4]	1987-88	8,661	631	9,292
Annual[4]	1988-89	8,765	622	9,387

1 Undergraduate quarterly credit hours divided by 15.

2 Graduate quarterly credit hours divided by 12.

3 Includes both Unrestricted and Restricted funded FTEs.

4 In accordance with CHE policy annual FTE is calculated by total undergraduate credit hours divided by 45 and total graduate credit hours divided by 36.

Independent Auditor's Report
& AES Financial Statements

STATE OF MONTANA

Office of the Legislative Auditor

STATE CAPITOL
HELENA, MONTANA 59620
406/444-3122

LEGISLATIVE AUDITOR:
SCOTT A. SEACAT

LEGAL COUNSEL:
JOHN W. NORTHEY

DEPUTY LEGISLATIVE AUDITORS:

MARY BRYSON
Operations and EDP Audit

JAMES GILLETT
Financial-Compliance Audit

JIM PELLEGRINI
Performance Audit

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Balance Sheet of the Montana Agriculture Experiment Station as of June 30, 1989, and the related Statements of Changes in Fund Balances and the Statements of Current Funds Revenues, Expenditures, and Other Changes for each of the two fiscal years ended June 30, 1989. These financial statements are the responsibility of Montana State University and Agriculture Experiment Station management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Agriculture Experiment Station as of June 30, 1989, and the changes in its fund balances and the current funds revenues, expenditures, and other changes for each of the two fiscal years then ended in conformity with generally accepted accounting principles.

Respectfully submitted,

James Gillett

James Gillett, CPA
Deputy Legislative Auditor

September 20, 1989

AGRICULTURAL EXPERIMENT STATION
BALANCE SHEET
June 30, 1989

ASSETS

CURRENT FUNDS:	
Unrestricted:	
General operating:	
Cash	$ 659,566
Accounts receivable	80,618
Due from other fund groups	49,869
Investments (Note 2)	317,000
Total general operating	1,107,053
Designated:	
Cash	180,635
Accounts receivable	19,581
Due from other fund groups	897
Total designated	201,113
Total unrestricted	1,308,166
Restricted:	
Cash Overdraft (Note 5)	(214,241)
Accounts receivable	396,617
Due from other fund groups	16,397
Investments (Note 2)	18,625
Total restricted	217,398
Total current funds	$ 1,525,564
PLANT FUNDS:	
Unexpended:	
Cash	$ 6,787
Accounts receivable	26,309
Investments (Note 2)	33,500
Total unexpended	66,596
Renewals and replacements:	
Cash	16,074
Accounts receivable	1,304
Due from other fund groups	5,470
Investments (Note 2)	169,300
Total renewals and replacements	192,148
Investment in plant:	
Land and land improvements	1,413,483
Buildings	4,178,979
Equipment	5,551,375
Livestock	1,766,077
Total investment in plant	12,909,914
Total plant funds	$13,168,658

See notes to financial statements.

AGRICULTURAL EXPERIMENT STATION
BALANCE SHEET (Cont.)

LIABILITIES AND FUND BALANCES

CURRENT FUNDS:	
Unrestricted:	
General operating:	
Accrued payroll	$ 461,056
Accounts payable and accrued liabilities	228,810
Due to other fund groups	15,194
Compensated absences payable (Note 4)	1,059,746
Fund balance (Note 1)	(657,753)
Total general operating	1,107,053
Designated:	
Accrued payroll	9,558
Accounts payable and accrued liabilities	11,447
Due to other fund groups	24,732
Compensated absences payable (Note 4)	5,746
Fund balance	149,630
Total designated	201,113
Total unrestricted	1,308,166
Restricted:	
Accrued payroll	2,870
Accounts payable and accrued liabilities	152,602
Due to other fund groups	65,771
Fund balance	(3,845)
Total restricted	217,398
Total current funds	$ 1,525,564
PLANT FUNDS:	
Unexpended:	
Accounts payable and accrued liabilities	$ 61
Fund balance	66,535
Total unexpended	66,596
Renewals and replacements:	
Accounts payable and accrued liabilities	4,307
Fund balance	187,841
Total renewals and replacements	192,148
Investment in plant:	
Net investment in plant	12,909,914
Total investment in plant	12,909,914
Total plant funds	$13,168,658

See notes to financial statements.

AGRICULTURAL EXPERIMENT STATION
STATEMENT OF CHANGES IN FUND BALANCES
YEAR ENDED JUNE 30, 1989

	Current Funds			Plant Funds		
	Unrestricted					
	General Operating	Designated	Restricted	Unexpended	Renewals and Replacements	Investment in Plant
Revenue and other additions:						
Current funds revenue	$8,926,793	$ 726,423	$2,853,675	-	-	-
Miscellaneous income	-	-	-	$48,163	$ 44,460	-
Expended for plant facilities (including $225,562 charged to current funds)	-	-	-	-	-	$ 255,198
Total revenue and other additions	8,926,793	726,423	2,853,675	48,163	44,460	255,198
Expenditures and other deductions:						
Current funds expenditures	8,793,175	566,107	2,827,010	-	-	-
Expended for plant facilities (including $39,289 non-capital expenditures)	-	-	-	18,760	56,005	-
Total expenditures and other deductions	8,793,175	566,107	2,827,010	18,760	56,005	-
Transfers among funds additions (deductions):						
Voluntary:	(12,268)	(24,532)	-	(5,200)	42,000	-
Total transfers	(12,268)	(24,532)	-	(5,200)	42,000	-
Net increase (decrease) in fund balance	121,350	135,784	26,665	24,203	30,455	255,198
Fund balances at beginning of year as previously reported	(734,544)	15,490	108	42,332	157,386	13,337,491
Adjustments: (Notes 1 & 4)						
Prior year revenues	1,828	-	(26,827)	-	-	-
Prior year expenditures	(2,335)	417	(3,791)	-	-	-
Compensated absences payable	(44,052)	(2,061)	-	-	-	-
Change in capitalization level	-	-	-	-	-	(417,787)
Other	-	-	-	-	-	(264,988)
Total adjustments	(44,559)	(1,644)	(30,618)	-	-	(682,775)
Fund balances at beginning of year as adjusted	(779,103)	13,846	(30,510)	42,332	157,386	12,654,716
Fund balances at end of year	$(657,753)	$149,630	$ (3,845)	$66,535	$187,841	$12,909,914

See notes to financial statements.

AGRICULTURAL EXPERIMENT STATION
STATEMENT OF CHANGES IN FUND BALANCES
YEAR ENDED JUNE 30, 1988

	Current Funds			Plant Funds		
	Unrestricted					
	General Operating	Designated	Restricted	Unexpended	Renewals and Replacements	Investment in Plant
Revenue and other additions:						
Current funds revenue	$8,663,291	$ 481,742	$2,415,841	-	-	-
Expended for plant facilities (including $283,341 charged to current funds)	-	-	-	$34,186	$ 33,688	$ 314,379
Total revenue and other additions	8,663,291	481,742	2,415,841	34,186	33,688	314,379
Expenditures and other deductions:						
Current funds expenditures	8,592,889	599,616	2,439,936	-	-	-
Expended for plant facilities (including $9,016 non-capital expenditures)	-	-	-	36,432	7,671	-
Total expenditures and other deductions	8,592,889	599,616	2,439,936	36,432	7,671	-
Transfers among funds - additions (deductions):						
Voluntary.	-	(8,500)	-	8,500	-	-
Total transfers	-	(8,500)	-	8,500	-	-
Net increase (decrease) in fund balance	70,402	(126,374)	(24,095)	6,254	26,017	314,379
Fund balances at beginning of year as previously reported	(764,032)	138,315	(8,884)	35,966	135,712	12,611,433
Adjustments: (Notes 1 & 4)						
Prior year revenues	(389)	22	(210)	(11)	(335)	-
Prior year expenditures	98	35	(33,456)	123	(4,008)	-
Compensated absences payable	(40,623)	3,492	74,083	-	-	-
Other	-	-	(7,330)	-	-	411,679
Total adjustments	(40,914)	3,549	33,087	112	(4,343)	411,679
Fund balances at beginning of year as adjusted	(804,946)	141,864	24,203	36,078	131,369	13,023,112
Fund balances at end of year	$(734,544)	$ 15,490	$ 108	$42,332	$157,386	$13,337,491

See notes to financial statements

AGRICULTURAL EXPERIMENT STATION
STATEMENT OF CURRENT FUNDS REVENUES, EXPENDITURES, AND OTHER CHANGES
YEAR ENDED JUNE 30, 1989

	Unrestricted			
	General Operating	Designated	Restricted	Total
Revenues:				
Federal appropriations	$1,813,206	-	-	$ 1,813,206
State appropriations	6,257,135	-	$ 55,824	6,312,959
Federal grants and contracts	-	-	1,210,562	1,210,562
State grants and contracts	-	-	646,954	646,954
Private grants, and contracts	-	-	913,670	913,670
Sales and service of educational activities	841,748	-	-	841,748
Other sources	14,704	$726,423		741,127
Total revenues	8,926,793	726,423	2,827,010	12,480,226
Expenditures:				
Research	7,813,662	-	2,811,422	10,625,084
Institutional support	800,769	-	-	800,769
Operation and maintenance of plant	178,744	-	-	178,744
Other	-	566,107	15,588	581,695
Total expenditures	8,793,175	566,107	2,827,010	12,186,292
Transfers and other additions (deductions):				
Transfers	(12,268)	(24,532)	-	(36,800)
Excess of transfers to revenue over receipts	-	-	26,665	26,665
Net increase (decrease) in fund balance	$ 121,350	$135,784	$ 26,665	$ 283,799

See notes to financial statements.

AGRICULTURAL EXPERIMENT STATION
STATEMENT OF CURRENT FUNDS REVENUES, EXPENDITURES, AND OTHER CHANGES
YEAR ENDED JUNE 30, 1988

	Unrestricted			
	General Operating	Designated	Restricted	Total
Revenues:				
Federal appropriations	$1,673,303	-	-	$ 1,673,303
State appropriations	6,204,968	-	$ 60,640	6,265,608
Federal grants and contracts	-	-	1,012,095	1,012,095
State grants and contracts	-	-	634,825	634,825
Private grants, and contracts	-	-	732,376	732,376
Sales and service of educational activities	775,815	-	-	775,815
Other sources	9,205	$ 481,742		490,947
Total revenues	8,663,291	481,742	2,439,936	11,584,969
Expenditures:				
Research	7,652,502	-	2,404,960	10,057,462
Institutional support	770,571	-	-	770,571
Operation and maintenance of plant	169,816	-	-	169,816
Other	-	599,616	34,976	634,592
Total expenditures	8,592,889	599,616	2,439,936	11,632,441
Transfers and other additions (deductions):				
Transfers	-	(8,500)	-	(8,500)
Excess of transfers to revenue over receipts	-	-	(24,095)	(24,095)
Net increase (decrease) in fund balance	$ 70,402	$(126,374)	$(24,095)	$(80,067)

See notes to financial statements.

MONTANA AGRICULTURE EXPERIMENT STATION

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 1989

1. Summary of significant accounting policies

Related parties:

Montana State University, Montana Agricultural Experiment Station, and Montana Extension Service are related through common management and control; however, they are separate and distinct agencies and they receive separate federal and state appropriations. These agencies have certain related-party transactions, including sharing office facilities, management, accounting and office services. The accounts of Montana State University and Montana Extension Service have not been included in the accompanying financial statements.

Financial statements:

The accompanying financial statements have been prepared on the accrual basis in accordance with generally accepted accounting principles for colleges and universities except as noted hereafter.

The statement of current funds revenues, expenditures, and other changes is a statement of financial activities of current funds related to the current reporting period and does not purport to present the results of operations or the net income or loss for the period.

Fund balance for unrestricted general operating funds includes $147 allocated for encumbrances and an unfunded liability of $1,059,746 for compensated absences payable.

Fund accounting:

The accounts of the Station are maintained in accordance with the principles of fund accounting wherein resources are classified for accounting purposes into funds that are identified by the limitations and restrictions placed upon their use. Separate accounts are maintained for each fund; however, accounts with common characteristics are combined into fund groups and reflected as such in the accompanying financial statements. The common characteristics of the funds contained in the various fund groups are as follows:

Current funds:

The current funds group includes economic resources expendable in performing the primary objectives of the Station, i.e., Research Institutional Support, and Operation of Plant. The current funds group has two basic distinct sub-groups: unrestricted funds which have no expenditure restrictions, and restricted funds which have expenditure restrictions. Unrestricted current funds are comprised of the following:

General Operating - utilized for general operations in performing the primary objectives of the Station.

Designated - utilized for educational related service activities; these funds are separately classified in order to accumulate and distinguish the costs of specialized service function areas.

Plant funds:

Plant funds are separated into three distinct self-balancing sub-group accounts:

Unexpended plant - utilized for acquisition of long-term institutional assets.

Renewal and replacement - utilized for long-term institutional asset maintenance.

Investment in plant - denotes the cost of long-term institutional assets and related liabilities.

Plant and equipment:

At June 30, 1989, investment in plant was adjusted $682,775 to reflect the totals in the property control subsidiaries. Livestock is carried at current market value with any difference from the prior year values reflected in this adjustment. Livestock is purchased and raised for experimental purposes; the revenues from livestock sales are recorded in the general operating fund, except when a breeding animal is sold and is expected to be replaced; then sales proceeds are recorded in designated funds and used for replacements as needed. Effective July 1, 1988, the equipment capitalization level increased from $200 to $500.

Depreciation:

No provision has been made for depreciation of plant facilities in accordance with generally accepted accounting principles for colleges and universities.

Allowances for bad debts:

An allowance for bad debts has not been recorded. Losses from bad debts are recorded as adjustments to revenue in the year in which they are deemed uncollectible.

Allocated for encumbrances:

The Station may record encumbrances of expenditures in conformance with the Statewide Budgeting and Accounting System. At June 30, 1989, the Station had encumbered $147 of general operating funds that are not included in expenditures in the accompanying financial statements. The accrual basis of accounting provides that expenditures include only amounts associated with goods and services received and that liabilities include only the unpaid amounts associated with such transactions.

2. Investments

Investments are carried at cost, which approximate market value at June 30, 1989. Investments at June 30, 1989 consist of the following:

	Cost
State of Montana short-term investment pool	$538,425

The investments at June 30, 1989 are owned by the following funds:

Current funds:	
General Operating	$317,000
Restricted	18,625
Plant funds:	
Unexpended plant	33,500
Renewals and replacements	169,300
	$538,425

3. Retirement plans

Eligible employees of the Station are members of the Montana Public Employees Retirement System, Montana Teacher's Retirement System or TIAA/CREF Optional Retirement Plan. These systems were determined to be actuarially sound by the most recent biennial valuations. The Station contributions to these plans were approximately $383,000 for fiscal year 1987-88 and $372,000 for fiscal year 1988-89.

4. Commitments and contingencies

Compensated absences payable:

As of December 31 of each year, employees can accumulate vacation leave up to twice the number of leave days earned annually and sick leave can be accumulated without limitation. Upon termination, the employee is paid the accumulated vacation leave and 25 percent of the accumulated sick leave. Vacation and sick leave payments are recorded as an expenditure at the time they are paid to the employee.

Due to system limitations, the change in the compensated absences payable amount is stated as an adjustment and not identified with the fiscal period earned or utilized by the employee.

5. Cash overdraft

The restricted current fund cash overdraft of $214,241 is due to cost reimbursable grants and contracts. The grants and contracts are accounted for by Montana State University with an adjustment made for reporting purposes to reflect this activity on the Agricultural Experiment Station financial statements as a separate agency. The interentity loan requirements of section 17-2-107, MCA are accounted for by Montana State University.

Independent Auditor's Report & ES Financial Statements

STATE OF MONTANA

Office of the Legislative Auditor

STATE CAPITOL
HELENA, MONTANA 59620
406/444-3122

LEGISLATIVE AUDITOR:
SCOTT A. SEACAT

LEGAL COUNSEL:
JOHN W. NORTHEY

DEPUTY LEGISLATIVE AUDITORS:

MARY BRYSON
Operations and EDP Audit

JAMES GILLETT
Financial-Compliance Audit

JIM PELLEGRINI
Performance Audit

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Balance Sheet of the Montana Extension Service as of June 30, 1989, and the related Statements of Changes in Fund Balances and the Statements of Current Funds Revenues, Expenditures, and Other Changes for each of the two fiscal years ended June 30, 1989. These financial statements are the responsibility of Montana State University and Extension Service management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Extension Service as of June 30, 1989, and the changes in its fund balances and the current funds revenues, expenditures, and other changes for each of the two fiscal years then ended in conformity with generally accepted accounting principles.

Respectfully submitted,

James Gillett, CPA
Deputy Legislative Auditor

September 20, 1989

MONTANA EXTENSION SERVICE
BALANCE SHEET
June 30, 1989

ASSETS

CURRENT FUNDS:	
Unrestricted:	
General operating:	
Cash	$1,036,695
Accounts receivable	3,065
Due from other fund groups	802
Total general operating	1,040,562
Designated:	
Cash	229,577
Accounts receivable	12,885
Due from other fund groups	50,708
Inventories	67,212
Total designated	360,382
Total unrestricted	1,400,944
Restricted:	
Cash	84,942
Accounts receivable	51,988
Due from other fund groups	41,365
Investments (Note 2)	1,052
Total restricted	179,347
Total current funds	$1,580,291
PLANT FUNDS:	
Investment in plant:	
Buildings	$ 44,993
Equipment	851,892
Total plant funds	$ 896,885

MONTANA EXTENSION SERVICE
BALANCE SHEET (Cont.)

LIABILITIES AND FUND BALANCES

CURRENT FUND	
Unrestricted:	
General operating:	
Accrued payroll	$ 208,786
Accounts payable and accrued liabilities	89,848
Due to other fund groups	69,015
Compensated absences payable (Note 4)	685,221
Fund balance (Note 1)	(12,308)
Total general operating	1,040,562
Designated:	
Accrued payroll	76,267
Accounts payable and accrued liabilities	23,058
Due to other fund groups	254
Compensated absences payable (Note 4)	154,321
Fund balance	106,482
Total designated	360,382
Total unrestricted	1,400,944
Restricted:	
Accrued payroll	43,012
Accounts payable and accrued liabilities	27,570
Due to other fund groups	3,448
Fund balance (Note 1)	105,317
Total restricted	179,347
Total current funds	$1,580,291
PLANT FUNDS:	
Investment in plant:	
Lease Payable	$ 7,260
Net investment in plant	889,625
Total plant funds	$ 896,885

See notes to financial statements.

MONTANA EXTENSION SERVICE
STATEMENT OF CHANGES IN FUND BALANCES
YEAR ENDED JUNE 30, 1989

	Current Funds			Plant Funds
	Unrestricted			
	General Operating	Designated	Restricted	Investment in Plant
Revenue and other additions:				
Current funds revenue	$4,427,677	$1,333,714	$1,160,083	-
Expended for plant facilities (including $105,029 charged to current funds expenditure)	-	-	-	$105,029
Total revenue and other additions	4,427,677	1,333,714	1,160,083	105,029
Expenditures and other deductions:				
Current funds expenditures	3,777,456	1,266,468	1,092,248	-
Leases payable	-	-	-	7,260
Total expenditures and other deductions	3,777,456	1,266,468	1,092,248	7,260
Net increase (decrease) for the year	650,221	67,246	67,835	97,768
Fund balances at beginning of year as previously reported	(93,608)	95,946	32,457	938,376
Adjustments: (Notes 1 & 4)				
Prior year revenues	(574,807)	(317)	9,920	-
Prior year expenditures	(946)	5,644	(4,895)	-
Compensated absences payable	6,832	(62,037)	-	
Change in capitalization level	-	-	-	(135,112)
Other				(11,408)
Total adjustments	(568,921)	(56,710)	5,025	(146,520)
Fund balances at beginning of year as adjusted	(662,529)	39,236	37,482	791,856
Fund balances at end of year	$ (12,308)	$ 106,482	$ 105,317	$889,625

See notes to financial statements.

MONTANA EXTENSION SERVICE
STATEMENT OF CHANGES IN FUND BALANCES
YEAR ENDED JUNE 30, 1988

	Current Funds			Plant Funds
	Unrestricted			
	General Operating	Designated	Restricted	Investment in Plant
Revenue and other additions:				
Current funds revenue	$4,355,652	$1,118,025	$1,127,835	-
Expended for plant facilities (including $69,140 charged to current funds expenditure)	-	-	-	$ 69,140
Total revenue and other additions	4,355,652	1,118,025	1,127,835	69,140
Expenditures and other deductions:				
Current funds expenditures	3,762,128	1,031,933	1,033,621	-
Total expenditures and other deductions	3,762,128	1,031,933	1,033,621	-
Net increase (decrease) for the year	593,524	86,092	94,214	69,140
Fund balances at beginning of year as previously reported	(996,824)	69,519	(125,059)	891,373
Adjustments: (Notes 1 & 4)				
Prior year revenues	249,118	(2,898)	8,179	-
Prior year expenditures	7,451	(6,029)	(5,693)	-
Compensated absences payable	53,123	(35,314)	61,240	-
Other		(15,424)	(424)	(22,137)
Total adjustments	309,692	(59,665)	63,302	(22,137)
Fund balances at beginning of year as adjusted	(687,132)	9,854	(61,757)	869,236
Fund balances at end of year	$ (93,608)	$ 95,946	$ 32,457	$938,376

See notes to financial statements.

MONTANA EXTENSION SERVICE
STATEMENT OF CURRENT FUNDS REVENUES, EXPENDITURES, AND OTHER CHANGES
YEAR ENDED JUNE 30, 1989

	Unrestricted			
	General Operating	Designated	Restricted	Total
Revenues:				
Federal appropriations	$1,893,510	-	-	$1,893,510
State appropriations	2,534,167	-	$ 53,055	2,587,222
Federal grants and contracts	-	-	944,192	944,192
State grants and contracts	-	-	27,472	27,472
Private grants, and contracts	-	-	62,222	62,222
Other sources		$1,333,714	5,307	1,339,021
Total revenues	4,427,677	1,333,714	1,092,248	6,853,639
Expenditures:				
Public service	3,289,863	-	1,092,248	4,382,111
Institutional support	430,193	-	-	430,193
Operation and maintenance of plant	57,400	-	-	57,400
Other	-	1,266,468	-	1,266,468
Total expenditures	3,777,456	1,266,468	1,092,248	6,136,172
Transfers and other additions (deductions):				
Excess of transfers to revenue over receipts	-	-	67,835	67,835
Net increase (decrease) in fund balance	$ 650,221	$ 67,246	$ 67,835	$ 785,302

See notes to financial statements.

MONTANA EXTENSION SERVICE
STATEMENT OF CURRENT FUNDS REVENUES, EXPENDITURES, AND OTHER CHANGES
YEAR ENDED JUNE 30, 1988

	Unrestricted			
	General Operating	Designated	Restricted	Total
Revenues:				
Federal appropriations	$1,829,268	-	-	$1,829,268
State appropriations	2,526,384	-	$ 55,028	2,581,412
Federal grants and contracts	-	-	826,252	826,252
State grants and contracts	-	-	39,035	39,035
Private gifts, grants and contracts	-	-	113,173	113,173
Other sources	-	$1,118,025	133	1,118,158
Total revenues	4,355,652	1,118,025	1,033,621	6,507,298
Expenditures:				
Public service	3,183,825	-	1,026,769	4,210,594
Institutional support	522,880	-	3,613	526,493
Operation and maintenance of plant	55,423	-	-	55,423
Other	-	1,031,933	3,239	1,035,172
Total expenditures	3,762,128	1,031,933	1,033,621	5,827,682
Transfers and other additions (deductions):				
Excess of restricted receipts over transfers to revenue	-	-	94,214	94,214
Net increase (decrease) in fund balance	$ 593,524	$ 86,092	$ 94,214	$ 773,830

See notes to financial statements.

MONTANA EXTENSION SERVICE

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 1989

1. Summary of significant accounting policies

Related parties:

Montana State University, Montana Agricultural Experiment Station, and Montana Extension Service are related through common management and control; however, they are separate and distinct agencies and they receive separate federal and state appropriations. These agencies have certain related-party transactions, including sharing office facilities, management, accounting and office services. The accounts of Montana Agricultural Experiment Station and Montana State University have not been included in the accompanying financial statements.

Financial statements:

The accompanying financial statements have been prepared on the accrual basis in accordance with generally accepted accounting principles for colleges and universities except as noted hereafter. The statement of current funds revenues, expenditures, and other changes is a statement of financial activities of current funds related to the current reporting period and does not purport to present the results of operations or the net income or loss for the period.

Fund balance for unrestricted general operating funds includes $2,335 allocated for encumbrances and unfunded liability of $685,221 for compensated absences payable.

Fund accounting:

The accounts of the Extension Service are maintained in accordance with the principles of fund accounting wherein resources are classified for accounting purposes into funds that are identified by the limitations and restrictions placed upon their use. Separate accounts are maintained for each fund; however, accounts with common characteristics are combined into fund groups and reflected as such in the accompanying financial statements.

Current funds:

The current funds group includes economic resources expendable in performing the primary objectives of the Extension Service, i.e., Public Service, Institutional Support, and Operation and Maintenance of Plant. The current funds group has two basic distinct sub-groups: Unrestricted Funds which have no expenditure restrictions, and Restricted Funds which have expenditure restrictions. Unrestricted current funds are comprised of the following:

General Operating - utilized for general operations in performing the primary objectives of the Extension Service.

Designated - utilized for educational related service activities; these funds are separately classified in order to accumulate and distinguish the costs of specialized service function areas.

Plant funds:

Investment in plant - denotes the cost of long-term institutional assets and related liabilities.

Inventory:

Inventory of paper and supplies are valued at cost (first-in, first-out method).

Plant and equipment:

At June 30, 1989, investment in plant was adjusted $146,520 to reflect the totals in the property control subsidiaries. Effective July 1, 1988, the equipment capitalization level increased from $200 to $500.

Depreciation:

No provision has been made for depreciation of plant facilities in accordance with generally accepted accounting principles for colleges and universities.

Allowances for bad debts:

An allowance for bad debts has not been recorded. Losses from bad debts are recorded as adjustments to revenue in the year in which they are deemed uncollectible.

Allocated for encumbrances:

The Extension Service records encumbrances of general operating funds as expenditures in conformance with the Statewide Budgeting and Accounting System.

At June 30, 1989, the Extension Service had encumbered $2,335 of general operating funds that are not included in expenditures in the accompanying financial statements. The accrual basis of accounting provides that expenditures include only amounts associated with goods and services received and that liabilities include only the unpaid amounts associated with such transactions.

2. <u>Investments</u>

Investments are carried at cost, which approximate market value at June 30, 1989. Investments at June 30, 1989 consist of the following:

	Cost
State of Montana short-term investment pool	$1,052

The investments at June 30, 1989 are owned by the following funds:

Current funds:	
Restricted	$1,052

3. Retirement plans

Eligible employees of the Extension Service are members of the Montana Public Employees Retirement System, Montana Teacher's Retirement System, U.S. Civil Services Retirement System or TIAA/CREF Optional Retirement Plan. The state of Montana retirement plans were determined to be actuarially sound by the most recent biennial valuations. The U.S. Civil Services Retirement System is not controlled by the state of Montana. The Extension Service contributions to these plans were approximately $338,000 for fiscal year 1987-88 and $355,000 for fiscal year 1988-89.

4. Commitments and contingencies

Compensated absences payable:

As of December 31 of each year, employees can accumulate vacation leave up to twice the number of leave days earned annually and sick leave can be accumulated without limitation. Upon termination, the employee is paid the accumulated vacation leave and 25 percent of the accumulated sick leave. Vacation and sick leave payments are recorded as an expenditure at the time they are paid to the employee.

Due to system limitations, the change in the compensated absences payable amount is stated as an adjustment and not identified with the fiscal period earned or utilized by the employee.

Leases:

The Extension Service reserves the right to limit the amount of expenditures associated with lease contracts without penalty when, in the sole judgment of the University, annual funding or program changes necessitate. Capital lease agreements at June 30, 1989 totaled $7,260 and are added to net investment in plant. Annual payments are:

Fiscal Year	Amount
1989-90	$2,420
1990-91	2,420
1991-92	2,420
Total	$7,260

University Response

MONTANA STATE UNIVERSITY
1893•CENTENNIAL•1993

Office of the President

103 Montana Hall
Montana State University
Bozeman, Montana 59717

Telephone 406-994-2341
FAX 406-994-2893

April 9, 1990

Mr. Scott Seacat
Legislative Auditor
Capitol Complex, Room 135
Helena, Mt 59620

Dear Scott:

The responses of MSU to the audit recommendations of the OLA for MSU, the Extension Service, and the Agricultural Experiment Station financial activity for fiscal years 1987-88 and 1988-89 are submitted herewith. We are pleased to receive an unqualified audit opinion on our financial statements. We will continue striving to maintain a high degree of accountability in our recording and reporting process.

The OLA report notes some serious issues which we have been dealing with since completing our May 1989 internal audit report. We are pleased that we have been able to address several of the concerns and have formulated resolution of a number of others, though limited resources prohibit resolution as quickly as we would like. The audit report reinforces many of the concerns we have been addressing, but the reader must recognize that your audit was conducted shortly after our internal audit report was released. As you are aware, our internal audit focused on one academic department, and much of your audit report was also based upon and directed at that same department.

In your report you expressed concern that you are unable to provide assurance to Federal grantors that MSU's grants and contracts (G&C) controls are adequate to ensure compliance with terms and conditions of federal programs. We do not believe that the magnitude of the findings and the materiality associated with those findings should result in such a statement. While we acknowledge the existence of certain problems, we strongly assert that the management of the G&C program is basically sound. We base our position on the following facts: 1) The identified control problems were primarily associated with a single academic department. We do not believe the findings from one department should be extrapolated to the entire G&C system. 2) The identified problem accounts represent less than 1% of the total G&C activity for the period under review. 3) Several circumstances which led to the findings were not within the University's purview. We simply cannot control a firm's bankruptcy, the death of a principal investigator (PI) or the exit of a PI who fails to complete a project to the satisfaction of the grantor. 4) Federal rules governing G&C activities are often in conflict with State rules or interpretation of these rules. For example, the auditors concluded that MSU had expended money for the Yellowstone Fire Symposium sponsored by the National Science Foundation without having received authorization. MSU <u>had</u> received verbal authorization and complied with Federal regulations regarding pre-award expenditures. Thus, the conclusion that these costs are "questioned" is misleading.

We agree that our internal control system can be improved and have initiated steps to strengthen our system. Our concern is with the auditor's judgment call regarding the G&C system. What is the threshold beyond which such a negative conclusion is rendered? It is our contention that the facts do not support the auditor's conclusion that assurance cannot be provided to Federal grantors regarding MSU's G&C program management. The auditors have publicly stated on numerous occasions that MSU has historically maintained very strong controls. These same controls are still in place and we agree that they must be consistently enforced.

We can document the actions MSU has taken to address the audit concerns, which include the following.

1) We have formalized deficit retirement procedures. Numerous problem accounts have already been resolved through written agreements with the PI's. Formal fiscal responsibility has been established for PI's who in the future spend in excess of their authorized budget.

2) MSU has billed sponsoring agencies for the large cost reimbursable contracts, which will reduce our reliance upon State funds, and has written to the primary sponsoring agencies seeking reconfirmation of the "unallowable costs" for the questioned equipment purchase.

3) Organizational responsibility for Chemistry Stores has been re-assigned from an academic department to an administrative department, and internal controls over purchases, sales, and the pricing structure have been implemented. Chemistry Stores was directed last fall to cease purchases of capital equipment.

4) The use of Already Received Purchase Requisitions (ARPR's) has been curbed, and a task force has developed a report detailing where violations are occurring so we can follow with corrective action. The ARPR form and

the accompanying instructions-for-use are being revised to specifically reflect the administrative policies governing exigency purchases.

5) In September 1989 MSU suspended use of "User Agreements" until the conflict between Federal and State laws can be resolved.

6) Use of the Contingency Revolving Fund(CRF) is being monitored closely for adherence with State rules and regulations. We have implemented multiple administrative reviews for check requests over $5,000 and $25,000 and have arranged alternative travel payment methods with local travel agents.

MSU continues to be faced with expectations of "doing more with less." Our G&C program has experienced unprecedented growth the past five years, almost doubling, while our staffing levels have remained constant. G&C activity has contributed significantly to our survival, particularly in the acquisition of capital equipment for instructional use. To address these demands, MSU has engaged external consultants to review the G&C organizational structure, reporting structure, staffing levels, operations support, and policy and procedure guides.

We look forward to meeting with the Audit Committee to discuss the audit report and our responses.

Sincerely,

William J. Tietz
President

cc: Commissioner of Higher Education

RECOMMENDATION NO. 1 -

WE RECOMMEND MSU IMPLEMENT A FORMAL PLAN TO ELIMINATE CASH DEFICITS CAUSED BY OVERSPENDING IN GRANT AND CONTRACT ACCOUNTS.

RESPONSE NO. 1 -

In several instances, MSU has incurred deficits in our grant and contract accounts due to no fault of the institution. In one instance the principal investigator (PI) died during the grant period and could not fulfill the terms and conditions of the grant. As a result of the PI's death the University incurred a $20,972 deficit. In a second instance, the project sponsor instituted bankruptcy proceedings and could not reimburse the institution for our expenditures, resulting in a deficit of $43,931. In a third case, a former faculty member left the University without fulfilling the terms of his contract, resulting in a deficit of $20,263. The University has pursued legal action and will receive periodic $2,500 payments until the full principal is reimbursed. In a fourth account, the deficit occurred when a private company refused to reimburse us in accordance with the contract terms. We are currently pursuing collection on this matter through legal channels.

MSU is very concerned with these deficits, and where possible, has been actively pursuing collection. We also understand that existing resources, such as indirect cost returns, will have to be used to retire these deficits.

Deficits are part of the risk the University assumes when we accept grants and contracts. While the appearance is poor indeed, when put in perspective, they represent less than 1% ($631,690 of approximately $73,000,000) of the total dollar volume activity during the period. In addition, the University has retired previous deficits and will continue to pursue its plan for deficit retirement.

The Legislative audit report states that these account "deficits" are recorded as "receivables." This is incorrect. Instead, taking a conservative approach based upon a previous OLA audit recommendation, the University sums the negative accounts with the positive accounts, including the cost-reimbursable receivables to determine the net "receivable" balance for financial statement purposes.

The question of "unallowable costs" is a technical audit issue regarding Federal grants and contracts. For the Federal NIH project examples referenced in the audit report, $165,782 are "questioned costs" only because they exceed the grant budgets and are recorded in the grant accounts, not because of the nature of the expenditures. Full reimbursement of these two grants has been received at their authorized level and these expenditures do not represent potential liabilities for repayment to the Federal government. The G&C overruns discussed represent University obligations which may be funded from any source determined appropriate by the University administration, just as other overruns in other accounts and fund groups are resolved. Of the $165,782 obligation, all but $58,500 has been resolved and eliminated.

It is important to note that MSU was well aware of the G&C account deficit problems, and that the deficits were not being ignored or hidden. We have been pursuing the deficit account elimination on an informal basis as funds have been available. We have formalized the deficit retirement process in order to monitor and record progress.

WE CONCUR, and can document an on-going plan to eliminate cash deficits in grant and contract accounts as resources are available. We have budgeted a FY 91 deficit reduction pool of $195,100. This pool is funded by indirect cost returns from those departments responsible for the deficits. We anticipate continuance of this deficit reduction commitment until all deficits have been retired. Moreover, we will continue to pursue legal action (breach of contracts, bankruptcy, etc.) where appropriate.

RECOMMENDATION NO. 2 -

WE RECOMMEND MSU MANAGEMENT:

A. IMPLEMENT PROCEDURES TO STRENGTHEN BUDGETARY CONTROLS OVER GRANTS AND CONTRACTS.

B. ESTABLISH RESPONSIBILITY FOR OVERSPENDING BY PRINCIPAL INVESTIGATORS.

C. REQUIRE PRINCIPAL INVESTIGATORS TO PROVIDE MORE TIMELY INFORMATION TO THE GRANTS AND CONTRACTS OFFICE.

D. MONITOR EXPENDITURES MORE CLOSELY FOR COMPLIANCE WITH ESTABLISHED BUDGETS.

RESPONSE NO. 2 -

Budgetary controls at the departmental level require cooperation and a timely information exchange between the principal investigator, the department head and the research administration. Established internal controls which prevent over-expenditures must be adhered to or they become ineffective. The three examples in the text of the audit report are drawn from the same department referred to throughout the report - a department which hosts one of the finest and most widely recognized teaching and research facilities in the northwest. Unfortunately, in working to develop that facility, numerous internal controls were bypassed, as noted in our May 1989 internal audit report dealing with this department.

Example #1 referenced on page 9 refers to equipment which was requisitioned in April 1987. A purchase order was issued in late June that year, charging the purchase to a designated account fund. The invoice from the vendor was dated August 1987, and the funding source was changed via a memo dated December 8, 1988. The purchase order was finalized December 15, 1988 and the payment authorization was processed on that date. A clerical error was made in recording the year the payment was made, FY88 rather than FY87. Several factors such as equipment testing and acceptance contributed to the delayed payment to the vendor.

Example #2 represents a partial transaction of a very large and complex purchase agreement. When a major piece of equipment was purchased, a technical addition (5mm probe and support system) was included in the purchase through a sub-contract with another vendor. During the term of the contract, the sub-contractor broke relations with the original vendor and MSU was asked to deal directly with the sub-contractor to obtain the necessary probe. MSU agreed to do this, but noted that the probe must be delivered and tested to ensure that it was satisfactory before payment would be made. The probe was provided to MSU in October 1988, and it was invoiced on March 31, 1989. The probe and system were accepted in early July 1989 after extensive testing, and the payment authorization was received in the MSU Business Office in late August 1989.

Example #3 reflects a difference of $66.24 between recorded and reported expenditures. The sponsor required a specific expenditure reporting format which differed from the State Budgeting and Accounting System (SBAS) format. This meant preparing a report using different expenditure object codes and classifications. We believe that with the exception noted above, the MSU records do support the final report submitted to the sponsoring agency. We received full payment from the sponsor and reimbursed the $66.24 to the sponsor on May 5, 1988.

WE CONCUR with #2(A) that we must rigorously enforce compliance with established internal controls through adherence with policies and procedures.

WE CONCUR with #2(B) and have supporting written documentation which reflect agreements for responsibility with principal investigators for any over-expenditures. We are formalizing the financial responsibility for G&C account deficits among the various levels of the University organization to reflect the organizational structure. The departments responsible for grant and contract deficits are being held accountable and the departmental indirect cost returns are being used to resolve those deficits. MSU has also contracted with a team of consultants to review financial responsibilities, and recommend policies and procedures which are appropriate to ensure good internal control.

WE CONCUR with #2(C) and have long pressed for timely and accurate information from the principal investigators. However, we find it extremely difficult to force this issue, particularly when vendors are complaining about unpaid invoices and the principal investigators are complaining about sub-standard equipment and unfulfilled purchase orders. We believe that it is in the best interests of the State to only obtain and pay for equipment which meets the needs and standards of the investigator, in accordance with the terms and conditions of the purchase orders.

WE CONCUR with #2(D) and have implemented several internal controls which will flag expenditure requisitions for approval and for funding needs, as well as reviewing and freezing those accounts where the expenditures and encumbrances have approached 95% of the authorized project level.

RECOMMENDATION NO. 3 -

WE RECOMMEND MSU OBTAIN WRITTEN DOCUMENTATION OF GRANT AWARDS AND SECURE FUNDING SOURCES BEFORE EXPENDING FUNDS FOR GRANTS AND CONTRACTS PROJECTS.

RESPONSE NO. 3 -

Example #1 in the OLA audit report does not accurately reflect the activity which took place. The expenditure of $16,281 was based upon verbal commitments made prior to receipt of the written award notice. Receiving verbal commitments to authorize pre-award expenditures are relatively common in G&C. In this particular case, MSU was requested to host a symposium on the fires in Yellowstone Park. The National Science Foundation (NSF) and other sponsors wanted the symposium held expeditiously in order to facilitate gathering critical data before winter, and thus, the pre-award expenditures were authorized. On October 11, 1988, a new G&C account was established for the $5000 received from one sponsor, and the receipt of an additional $27,500 from other sponsors was pending. These additional verbal commitments met MSU's requirements for establishing this account. The National Science Foundation formally awarded $20,000 on April 19, 1989, through an existing NSF grant.

The NSF and other agencies have formal guidelines for pre-award expenditures using the Organizational Prior Approval System (OPAS). In order to use OPAS, as authorized by NSF, the following must occur:

A) there must be a written request from the principal investigator for authorization to proceed,

B) the principal investigator must obtain the name, address, and telephone number of the sponsoring agency representative or program director,

C) the institutional research committee must review the potential commitment to the department and principal investigator if the award does not materialize, for whatever reason,

D) the institutional research committee must obtain a verbal commitment from the sponsoring agency,

E) the institutional research committee members must discuss the situation and either approve or deny the action, and

F) upon approval by the institutional research committee, the project is established and the principal investigator is advised in writing that their department accepts the potential liability for expenditures if the award does not materialize for whatever reason.

Example #2 from the OLA audit report also inaccurately portrays the events regarding the remodeling of a new professor's laboratory. The $80,000 from existing indirect cost recoveries was committed by the University, and an agreement was signed to allow an additional $50,000 commitment from departmental funds and/or from the professor's anticipated G&C project indirect cost recoveries.

The bill for $35,145 was paid by the Physical Plant as a means of immediately satisfying the vendor. For whatever reason, payment for two previous invoices had been delayed, and MSU chose to pay the vendor immediately. It was our intent to correct the expenditure as soon as the appropriate accounts were identified. MSU has made the expenditure correction to the proper G&C account.

Example #3 from the OLA audit report referencing the "mini-rental" designated account contained only <u>one</u> unfunded user agreement payment as of June 30, 1989. The unfunded payment has been made by the department responsible. The remainder of the balance in the account provided a faculty start-up package and equipped a laboratory facility. Using departmental indirect cost returns, $14,611 has been paid to the "mini-rental" account this fiscal year and the remainder is budgeted for repayment over the next three years. The account has been used primarily to record collections of user fees which are transmitted periodically to the MSU Foundation, as discussed later in this response.

WE PARTIALLY CONCUR with this recommendation, as it is standard practice to obtain verbal rather than written notification of grant awards which allows MSU to exercise the pre-award expenditure option in order to execute obligations in a timely manner. To wait until written authorization is received would severely hamper critical research efforts where the immediate collection of data or conduct of business is of the utmost importance. We will, however, provide better file documentation for an audit trail when verbal awards are offered and accepted.

RECOMMENDATION NO. 4 -

WE RECOMMEND MSU:

A. STRENGTHEN PROCEDURES TO TRACK MATCHING AND COST SHARING REQUIREMENTS IN GRANT RECORDS OF THE GRANTS AND CONTRACTS OFFICE TO ENSURE GRANT REQUIREMENTS ARE MET; AND

B. IMPROVE DOCUMENTATION OF GRANT ACTIVITY IN THE GRANT CONTROL SYSTEM.

The examples used were again from the department previously referenced. MSU recognizes the need to carefully and fully document grant files, but takes exception to the statement in example #1 that the $100,000 is a "questioned cost." The documentation for this expenditure of funds was not centralized at the time of the audit, but was fully supported with written narrative. Essentially, the funds were used to network chemistry computing equipment with other computing resources.

Billing for this project was submitted to the sponsoring agency periodically, but reimbursement was refused until the equipment was tested and approved, and the support documentation was provided. The final project billing was submitted to the sponsoring agency on January 24, 1990, a subsequent facility site visit was conducted, and the facility was approved by the sponsor.

In reference to example #2, it is important to note that MSU had submitted the final report and billing for reimbursement and the file had been closed subsequent to the audit. The matching documentation has been provided to the sponsoring agency.

WE CONCUR with both 4(A&B) and will take the necessary steps to more carefully document the grant files, and track and record the matching expenditures in accordance with our existing procedures.

RECOMMENDATION NO. 5 -

WE RECOMMEND MSU:

A. REVIEW PROCEDURES TO ENSURE AUTOMATIC BILLINGS CORRECTLY CLASSIFY EXPENDITURES IN THE ACCOUNTING RECORDS.

B. REVIEW AUTOMATIC BILLINGS TO GRANT PROJECTS TO IDENTIFY INSTANCES OF UNALLOWABLE EQUIPMENT PURCHASES OR MARKUPS.

C. CHARGE ONLY ACTUAL COSTS FOR EQUIPMENT PURCHASES BILLED TO GRANT PROJECTS.

D. RE-EVALUATE THE ROLE OF CHEMISTRY STORES EQUIPMENT PURCHASES.

RESPONSE NO. 5 -

Again, it is important to note that the examples provided in the OLA audit report were drawn specifically from the department identified previously.

WE CONCUR with #5(A) and have directed Chemistry Stores to refer all purchases for other than chemistry supplies to the MSU Purchasing Department. The automatic billing system will appropriately object code all sales through Chemistry Stores as supply expenditures.

WE DO NOT CONCUR with #5(B), as it would be an inappropriate use of staff time to review supply purchases paid for through the automatic billing function. No University automatic billing entities are allowed to purchase equipment for re-sale as Chemistry Stores was doing.

We believe that the principal investigators must be responsible for making purchases which are in accordance with the grant or contract terms. As a means of strengthening our internal control system, we are having a consultant prepare a written procedures guide for principal investigators.

WE CONCUR with #5(C) and have recognized that this is an important Federal compliance issue. Re-directing the purchasing responsibility to our Purchasing Department will ensure that we are in compliance.

WE CONCUR with #5(D) and have directed Chemistry Stores to cease purchasing equipment for re-sale. In addition, because of numerous problems with Chemistry Stores, we have re-assigned the responsibility for Chemistry Stores management from the academic department to an administrative department.

RECOMMENDATION NO. 6 -

WE RECOMMEND MSU MONITOR CASH BALANCES AND REQUEST GRANT MONEYS IN A MANNER WHICH MINIMIZES THE NECESSITY FOR STATE FUNDS TO ADVANCE CASH TO GRANT PROGRAMS.

RESPONSE NO. 6 -

Upon reviewing the increasing level of State funds used to temporarily support grant activity on page 18 of the OLA audit report, the reader must also recognize that grant and contract activity at MSU has grown dramatically from an FY84 total of $9,067,789 to an FY89 total of $15,775,928. We are projecting an

FY90 total of $17,400,000. The vast majority of G&C contracts are cost reimbursable, and the temporary use of State funds is a cost of participating in this type of G&C funded activity. Cost reimbursement is governed by the terms of the grant contract.

MSU has taken steps to decrease reliance on advanced State funds for grant programs. The audit report refers to the ordering of reimbursement funds <u>after</u> the monthly payroll as one major step in better cash management. In addition, MSU has significantly increased the number of contracts which allow monthly billing for reimbursement, though we must still abide by the billing terms of the contract. Wire transfers are utilized to avoid delays with the reimbursements, and requisitions must be approved by the G&C administration, which also allows Federal funds to be ordered in anticipation of the receipt of major equipment.

Delayed payment for cost reimbursable grants and contracts with other State agencies also contributes to our cash management problems. In excess of 12% ($235,270) of our receivables balance for the month of March 1990 is due to unpaid billings over 30 days old from other State agencies, including Office of Public Instruction, Department of Natural Resources and Conservation, Department of Health and Environmental Sciences, Department of Fish, Wildlife and Parks, Department of Highways, and Department of Agriculture.

WE CONCUR with this recommendation and are making every reasonable effort to reduce lost interest income on State funds and still comply with Federal regulations. It should be noted that past Federal audit reports were critical of MSU for maintaining any Federal cash balances. It is impossible to not incur deficits in State funds without maintaining cash balances of Federal funds. MSU is thus placed in a compromised position where resolution to the satisfaction of all parties is available only through instantaneous cash transfers as expenditures occur. MSU will seek to address this conflict, possibly through a change in State Statute as was done for the Department of Social and Rehabilitation Services and the Department of Highways.

<u>RECOMMENDATION NO. 7 -</u>

WE RECOMMEND MSU COMPLY WITH STATE PURCHASING LAWS FOR EQUIPMENT ACQUISITIONS.

<u>RESPONSE NO. 7 -</u>

WE CONCUR with this recommendation, not only for the purchase of equipment, but for <u>all</u> purchases. In 1981, MSU established a formal agreement, policies, and procedures with the MSU Foundation to allow "on behalf of financing" through the user agreements. This legal arrangement allowed MSU to make a formal request to the Foundation for capital equipment, the Foundation purchased the desired equipment using their funding, and the department which made the request then paid a period charge based upon actual use of the equipment. This procedure called for payments for the use of the equipment until the Foundation recaptured all of its costs of purchasing and providing the equipment. The IRS Codes required the Foundation to gift the equipment to MSU at that time, and MSU recorded the gift at fair market value.

In a single instance concerning the department previously identified, the procedures which govern the use of this agreement were breached. Though MSU recognizes the use agreement as an accepted method of procurement for capital equipment, the purchaser must adhere to the procedures set forth in the MSU/Foundation agreement, or the purchase takes on other appearances which may not be appropriate or recognized by MSU. Because it was MSU's intent to provide equipment using this legal, recognized, and accepted means of procurement, the grant proposals and subsequent correspondence with the sponsors relate how the purchases were to occur. To confirm that we are in compliance with the terms and conditions of the contracts, MSU has written to each of the Federal sponsors and asked for re-confirmation of this specific issue.

RECOMMENDATION NO. 8 -

WE RECOMMEND MSU MANAGEMENT LIMIT THE USE OF ALREADY RECEIVED PURCHASE REQUISITIONS AND EXIGENCY PURCHASES TO EMERGENCY SITUATIONS AS REQUIRED BY STATE POLICY.

RESPONSE NO. 8 -

WE CONCUR and have taken steps to more closely monitor such use on a campus wide basis. A task force has been established to review use of Already Received Purchase Requisitions (ARPR's), and directives have been issued to certain departments advising them that ARPR's will not be allowed except for true emergencies. We already have or will be implementing the following internal controls: 1) requiring departments to improve their justification for the use of ARPR's; 2) re-designing the ARPR form so that it is very clear that such use is to be only for emergencies; 3) advising those who authorize ARPR's that approval must be based upon the need to address a true emergency; and 4) working administratively with those departments which appear to be abusing the use of ARPR's by utilizing other available alternatives for frequent purchases of an unknown nature or quantity. Those who do not abide will be forced to return the goods and settle with the vendor. We believe that there is a need for legitimate ARPR's, and are willing to abide by the procedures governing their use.

RECOMMENDATION NO. 9 -

WE RECOMMEND MSU MANAGEMENT CONTROL GRANT AND CONTRACT EXPENDITURES AND ENSURE COMPLIANCE WITH CONTRACTUAL AGREEMENTS.

RESPONSE NO. 9 -

WE CONCUR with this recommendation, as noted in Response No. 2, and are taking the appropriate and necessary steps to better ensure that activities are in compliance with already-established policies and procedures. Where necessary, internal controls are being strengthened through the development of additional procedures, and oversight of activities is being increased as needed.

RECOMMENDATION NO. 10 -

WE RECOMMEND MSU RECORD THE MUSEUM DEPARTMENT OPERATIONS ON ITS ACCOUNTING RECORDS.

RESPONSE NO. 10 -

WE CONCUR and are taking steps to further clarify the relationship between the Museum of the Rockies, Inc. and MSU. We have asked that all operating funds provided to the Museum Department by the Museum Inc. be formally transmitted as a contracted activity, effective July 1, 1990. All MSU revenues and expenditures in support of the Museum Department will be appropriately recorded and reported. The Museum Department will be treated as any other department with respect to budgeting, accounting, and reporting, just as is currently being done with regard to personnel practices, travel, and purchasing.

RECOMMENDATION NO. 11 -

WE RECOMMEND MSU USE THE CONTINGENT REVOLVING ACCOUNT IN COMPLIANCE WITH STATE POLICY.

RESPONSE NO. 11 -

WE CONCUR and believe we have taken steps to better control the use of the Contingent Revolving Fund (CRF). After receiving a similar audit recommendation two years ago, MSU implemented several controls to reduce the use of the CRF. Unfortunately, our reduction efforts were offset by other operational changes. These primary changes included: 1) the implementation of a new financial computing software system, and 2) the elimination of Travel Purchase Order (TPO) use to strengthen internal controls. The TPO use was eliminated when an internal audit revealed that TPO's were not being used in accordance with University policies, and the necessary Travel Justifications were not being submitted as required. Together, these two changes resulted in a 30% increase in CRF activity. When elements #1 & #2 are combined with our improved CRF controls, the net change in activity was negligible and it appears that MSU did not implement the previous audit recommendation. That is an incorrect conclusion.

We continue to exercise improved controls over the use of the CRF. In December 1989, we were able to work out an arrangement with the local travel agents which will eliminate the use of the CRF for travel, except for true unanticipated travel. This change, combined with other changes, has resulted in a 35% decrease in use of the CRF the past three months.

In order to better ensure compliance in use of the CRF, the bank signature cards have been updated, and multiple review and signatures are now required for claims exceeding $5,000. Claims which exceed $25,000 must be reviewed and approved at the Vice Presidential level if they are to be paid with a CRF check. A decrease in the use of ARPR's should also result in a decrease in the use of the CRF, as tardy payments are often being made for goods. The individual review of each claim presented for payment with a CRF check has also reduced the volume of use of the CRF.

RECOMMENDATION NO. 12 -

WE RECOMMEND MSU:

A. RETURN $207,063 TO THE GENERAL FUND.
B. COMPLY WITH SECTION 17-2-208, MCA, AND USE NON-GENERAL FUND MONEY FIRST.
C. RECORD EXPENDITURES ONLY WHEN A VALID OBLIGATION EXISTS.

RESPONSE NO. 12 -

MSU received written notification of the accepted energy conservation grant prior to the end of FY88. In order to accept the energy conservation grant, MSU was required to provide $135,538 in matching funds. Since southwest Montana had experienced a milder than anticipated winter, and since we had received written notification of the grant award prior to the end of the fiscal year, the FY88 energy savings were committed to this energy conservation project.

The actual grant award arrived in FY89 and preliminary work began. However, due to a series of unanticipated delays, the work has not yet been completed, and a request for an extension has been submitted to and approved by The Department of Natural Resources and Conservation, the sponsoring agency.

The engineering analysis for this project reflects an estimated annual savings of approximately $79,912. The total project cost was $404,882. State funds financed one-half of the total project costs. At current electric rates, the average payback period is approximately 2.5 years. Our ability to commit year-end savings will result in significant energy savings over the life of the buildings at MSU. MSU had demonstrated to the Finance sub-committee and the Legislative Fiscal Analyst that significant energy savings could accrue if funds could be invested in energy conservation matching grant programs. The Legislature agreed with our position and asked that we reinvest all future energy savings for either energy savings programs or deferred maintenance. This project is the result of our legislative agreement. Had MSU not been advised in FY88 that the grant award was forthcoming, the energy savings would have instead been used for other campus maintenance projects.

WE DO NOT CONCUR with recommendation #12(A). We believe that we acted in the best interests of the State and that we were in full compliance with established policies and procedures, as well as Legislative intent, when the funds were set aside for energy conservation and when other funds were used for remodeling, as noted below.

WE CONCUR with recommendation #12(B), and believe that we are in full compliance with the referenced Statute. When MSU began the construction project, the $150,000 from Auxiliary funds was to be used for renovation of part of a facility which could then be rented to other campus entities on a recharge basis. Later in 1989 when the Legislature approved the partial building occupation for State activities and appropriated the operational support costs for those State supported entities, the costs associated with remodeling for the State activities were corrected and funded with State funds.

MSU erred in not appropriately updating the Plant fund account from $150,000 to $225,000 when it was determined that the Legislature had approved the takeover of the building and provided the operational support costs. This would have clarified the matter, and had the $71,525 in State funds not been used to fund State-related expenditures in the renovation, they would have been used for other planned projects awaiting funding.

WE CONCUR with recommendation #12(C) and believe that we have properly complied with this both in form and in function.

RECOMMENDATION NO. 13 -

WE RECOMMEND MSU RECORD PROFITS FROM FIXED PRICE CONTRACTS AND ADMINISTRATIVE COST ALLOWANCES IN THE UNRESTRICTED FUND.

RESPONSE NO. 13 -

WE CONCUR with this recommendation and are developing procedures to identify the few fixed price contracts which are administered annually and which are completed at less than contract price so that the residual funds can be recorded in the designated Unrestricted Fund.

The cash receipt for the largest single deposit of administrative cost allowances ($17,940) designated the deposit to the General Operations unrestricted account. However, the wrong account number was used by MSU. This deposit has been corrected in the accounting records. While it is difficult to prevent human error, in the future, SBAS reports will be referenced by the MSU Financial Aid administration to ensure that deposits are credited to the proper account.

RECOMMENDATION NO. 14 -

WE RECOMMEND MSU ACCOUNT FOR CAPITAL LEASES IN ACCORDANCE WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES.

RESPONSE NO. 14 -

We believe that if the terms of the User Agreements are followed, that they do not constitute a capital lease. Varying levels of payment are made over a period not to exceed three years, and there is no recorded liability since the MSU Foundation is responsible for the equipment in the event of default on payment. In accordance with GAAP, the fair market value of the equipment is recorded at the time the equipment is gifted to MSU.

WE CONCUR with this recommendation and annually report such agreements as required. All User Agreements have been fulfilled by MSU and if this system is a problem, alternative methods of acquiring future capital equipment will be explored.

RECOMMENDATION NO. 15 -

WE RECOMMEND MSU RECORD EXPENDITURES IN THE PROPER YEAR IN COMPLIANCE WITH STATE ACCOUNTING POLICY.

RESPONSE NO. 15 -

WE CONCUR with this recommendation and will make every reasonable effort to ensure such compliance in recording expenditures in the proper year.