OLA

OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Financial Audit Division Report

Board of Water and Soil Resources

Fiscal Years 2000 through 2003

JULY 29, 2004 **04-30**

Financial Audit Division

The Office of the Legislative Auditor (OLA) is a professional, nonpartisan office in the legislative branch of Minnesota state government. Its principal responsibility is to audit and evaluate the agencies and programs of state government (the State Auditor audits local governments).

OLA's Financial Audit Division annually audits the state's financial statements and, on a rotating schedule, audits agencies in the executive and judicial branches of state government, three metropolitan agencies, and several "semi-state" organizations. The division also investigates allegations that state resources have been used inappropriately.

The division has a staff of approximately forty auditors, most of whom are CPAs. The division conducts audits in accordance with standards established by the American Institute of Certified Public Accountants and the Comptroller General of the United States.

Consistent with OLA's mission, the Financial Audit Division works to:

- Promote Accountability,
- Strengthen Legislative Oversight, and
- Support Good Financial Management.

Through its Program Evaluation Division, OLA conducts several evaluations each year.

OLA is under the direction of the Legislative Auditor, who is appointed for a six-year term by the Legislative Audit Commission (LAC). The LAC is a bipartisan commission of representatives and senators. It annually selects topics for the Program Evaluation Division, but is generally not involved in scheduling financial audits.

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Representative Tim Wilkin, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Ronald Harnack, Executive Director
Minnesota Board of Water and Soil Resources

Members of the Minnesota Board of Water and Soil Resources

We have audited selected areas of the Minnesota Board of Water and Soil Resources (board) for the period from July 1, 2000, through June 30, 2003. Our audit scope was limited to grant expenditures and easement and conservation plan payments. The Report Summary highlights our overall audit conclusions. The specific audit objectives and conclusions are contained in the individual chapters of this report.

We selected the board for audit based on our annual assessment of state agencies and programs. We used various criteria to determine the entities to audit, including the size and type of each agency's financial operations, length of time since the last audit, changes in organizational structure and key personnel, and available audit resources.

We conducted our audit in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we obtain an understanding of the board's internal controls relevant to the audit objectives. We used the guidance contained in *Internal Control-Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission, as our criteria to evaluate agency controls. The standards also require that we plan the audit to provide reasonable assurance that the board complied with financial-related legal provisions that are significant to the audit. In determining the board's compliance with legal provisions, we considered requirements of laws, regulations, contracts, and grant agreements.

To meet the audit objectives in the areas audited, we gained an understanding of the board's financial policies and procedures. We considered the risk of misstatements in the accounting records and noncompliance with relevant legal provisions. We analyzed accounting data to identify unusual trends or significant changes in financial operations. We examined a sample of evidence supporting the agency's internal controls and compliance with laws, regulations, contracts, and grant provisions.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: April 6, 2004

Report Signed On: July 23, 2004

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Audit Participation

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

Claudia Gudvangen, CPA	Deputy Legislative Auditor
Jeanine Leifeld, CPA,CISA	Audit Manager
Doreen Bragstad, CPA	Auditor-in-Charge

Exit Conference

We discussed the findings and recommendations in this report with the following staff of the Minnesota Board of Water and Soil Resources on July 8, 2004.

Ron Harnack	Executive Director
Bill Eisele	Administrative Services Director
Wayne Zellmer	Grant Coordinator
Jerome Deal	Board Chair

Report Summary

Key Findings:

- The board did not ensure that natural resources block grant recipients met the legally mandated matching requirements. According to the appropriation law, recipients must match certain grants with either local cash and/or in-kind contributions. (Finding 1, page 7)
- In several cases, the board used funds from one grant program to supplement spending in another program. Within the board's appropriation law, the legislature included specific dollar amounts for each grant program. The board does not have the authority to transfer funds between these programs. (Finding 2, page 8)

The report contained a total of 3 findings. Two of the three findings involved the board's compliance with legal requirements.

Audit Scope:

Audit Period: From July 1, 2000 through June 30, 2003

Programs Audited:
- Grants
  - Natural Resources Block
  - Cost Share
  - General Services
- Easement Purchases and Conservation Plan Payments

Agency Background:

The Minnesota Board of Water and Soil Resources assists local government units in managing water and soil resources by providing technical, administrative, and financial assistance. In the past three years, it gave out grants totaling $51 million and paid $70 million for easement purchases and conservation plans.

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Chapter 1. Introduction

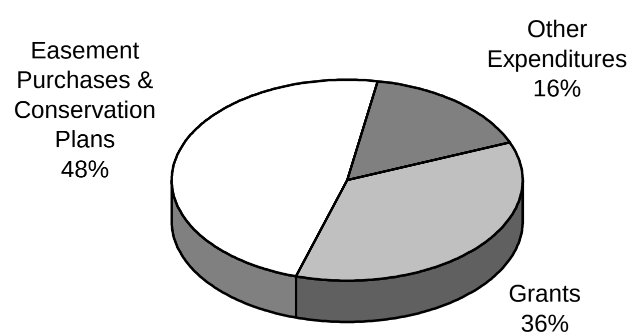
The Minnesota Board of Water and Soil Resources (board) operates pursuant to Minn. Stat. Section 103B. The board is the state's administrative agency for 91 soil and water conservation districts, 45 watershed districts, 27 metropolitan watersheds, and 80 county water management organizations. The board's mission is to assist local government units in managing water and soil resources by providing technical, administrative, and financial assistance.

The board consists of 17 members, including three citizens, five representatives of designated state agencies and the University of Minnesota, and three representatives each from local soil and water districts, watershed management organizations, and counties. The Governor appoints board members to four-year terms, and the board meets 11 times per year. Ronald Harnack is the board's current executive director. The agency's staff members are located in eight field offices: St. Paul, Rochester, Marshall, New Ulm, Brainerd, Bemidji, Fergus Falls, and Duluth.

The state's General Fund is the primary source of funding for the board's grant programs. The board also receives bonding money for the purchase of easements. The majority of the funds pass through to local governments that administer state policies and programs for which the agency is responsible. During the three-year audit period, the board spent a total of almost $144 million. As shown in Figure 1-1, grant expenditures and easement and conservation plan payments account for about 84 percent of the board's total expenditures. Other expenditures include payroll and other administrative costs.

Our audit included a review of selected financial activities of the Board of Water and Soil Resources, focusing on grants and easement expenditures. The following report chapters discuss our review of internal controls and compliance with significant laws and regulations for those areas.

Figure 1-1
Board of Water and Soil Resources Expenditures
Payments during Fiscal Years 2001 – 2003



Source: Minnesota Accounting and Procurement System (MAPS), payments coded to accounting fiscal year 2003 or prior, paid between July 1, 2000, and January 1, 2004.

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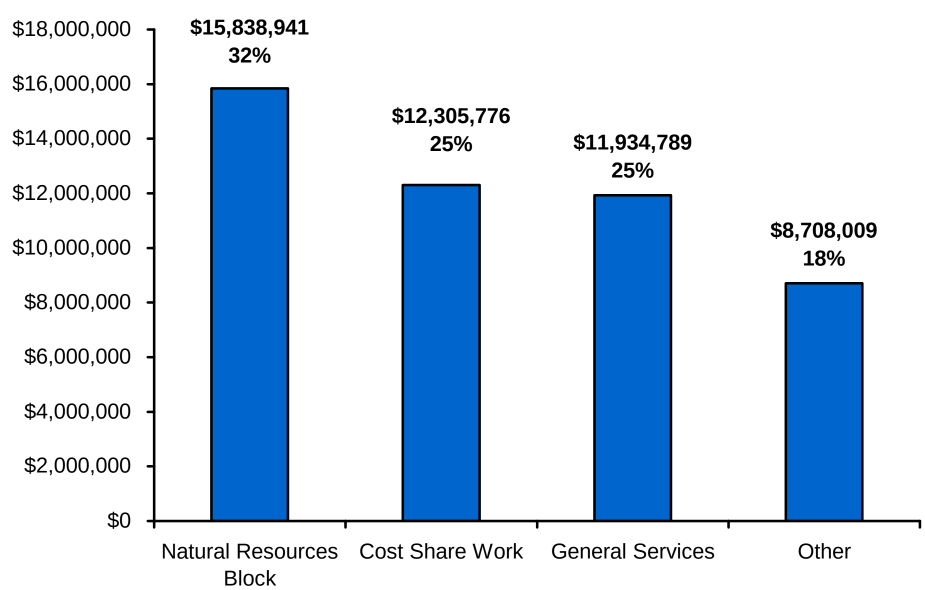
Chapter 2. Grant Expenditures

Chapter Conclusions

The Board of Water and Soil Resources did not comply with the related appropriation laws in making grants to counties and soil and water conservation districts. The board did not ensure that grantees met the legally mandated matching requirements. The board also did not demonstrate that it met the appropriation law requirements for certain grant expenditures. For the items tested, the grant contracts and proposed grantee spending were in accordance with the intent of the appropriation laws.

The Board of Water and Soil Resources awards grants for financial, technical, and administrative assistance for conservation, erosion control, and water quality management practices and programs. The board gives most of its grants to local units of government, primarily counties and soil and water conservation districts. Grant expenditures totaled $48,787,515 for budget fiscal years 2001 through 2003 and are shown by appropriation category in Figure 2-1.

Figure 2-1
Grant Expenditures by Type
Budget Fiscal Years 2001-2003



Source: Minnesota Accounting and Procurement System (MAPS), budgetary fiscal years 2001 through 2003, as of January 1, 2004.

Minnesota Board of Water and Soil Resources

Audit Objectives

Our audit of grant expenditures focused on the following objectives:

- Did the board's internal controls provide reasonable assurance that grant expenditures were accurately reported in the accounting records and in compliance with applicable legal provisions and management's authorization?
- Were grant expenditures in accordance with related grant agreements and other state requirements?
- Were the grant contracts and proposed grantee spending in accordance with the intent of the appropriation or source of funding?

We limited our audit work to the board's three largest grant programs: natural resources block grants, cost share work grants, and general services grants.

Natural Resources Block Grants

The board awards natural resources block grants to counties for comprehensive local water plan and wetland conservation act implementation. Through these grants, the board also distributes Department of Natural Resources shoreland management funds, as well as Minnesota Pollution Control Agency feedlot permit and sewage treatment funds. Counties may apply for any or all of the programs. Counties submit grant applications and work plans to request funds under the block grant for a two-year period, beginning January 1. Although the grant agreements cover a two-year period, counties may apply for each grant on an annual basis. To be eligible, a county must have a locally adopted and Board of Water and Soil Resources approved comprehensive local water management plan, provide a resolution authorizing a required match, and submit an annual report to the board.

The board determines the awards for the local water planning and wetland conservation act portions of the program based on a formula. The Department of Natural Resources determines the awards for the shoreland management grant. The Pollution Control Agency determines the awards for the feedlot permit and sewage treatment portions of the block grant. The sewage treatment grants were a flat amount per county during the audit period.

Cost Share Work Grants

Cost share work grants provide funding to soil and water conservation districts to share the cost of implementing water quality and erosion control practices. In cooperation with landowners, the districts implement practices to protect and improve soil and water resources, such as strip cropping, terraces, storm water control systems, and field windbreaks. These grants include the following programs: cost-share base grants, special projects, Minnesota River basin, and feedlot water quality management. The conservation districts must use funds granted for feedlot projects to improve waste management systems that benefit water quality for small feedlots.

Minnesota Board of Water and Soil Resources

The state's 91 soil and water conservation districts all are eligible for the base grant, as long as the board has received the district's long-range and annual plans and an annual report. Beginning in fiscal year 2003, the board built an annual performance adjustment into the base amount. Each district's future grants will be adjusted based on past performance. The board determines the funding for special projects and feedlot grants on a competitive basis according to a priority system.

General Service Grants

The board provides general service grants to the soil and water conservation districts for their general operations, such as payroll, office space rental, and utilities. These grants also provide nonpoint engineering to support the salaries of a district engineer and technician. To qualify for this grant, each district submits an annual plan, comprehensive plan, and an annual report.

In addition to the general services portion, a soil and water district may receive a Reinvest in Minnesota service grant to assist with easement program implementation costs. The 11 joint powers groups of soil and water conservation districts apply for this grant and act as fiscal agents for the local districts.

Our audit identified two issues relating to the board's grant programs.

1. The Board of Water and Soil Resources did not ensure that grantees met the legally mandated matching requirements.

The board did not verify that counties and other local units of government receiving certain natural resources block grant program funds had met the legally required match. The appropriation language for grants awarded under this program states, "Grants must be matched with a combination of local cash or in-kind contributions." The match requirement is a one-to-one cash and/or in-kind contribution for the wetland conservation, shoreland, and feedlot grants. The law also appropriates specific amounts from the natural resources block grant to the North Shore Management Board, the St. Louis River Board, the Minnesota River Basin Board, and the Southeast Minnesota Resources Board. These specific grantees are also subject to the one-to-one matching requirement.

The board does not require the grantees to provide supporting documentation to assure that the match was met. To verify the match, the board merely requires county officials to sign an allocation and contribution plan as a part of their grant request, which states, "By signing below, we are agreeing to expend grant funds, match and provide documentation for the match in the amounts listed above." However, the board does not request any documentation and, according to board grant staff, the board's conservationists do not review documentation relating to the match as part of their closeout procedures. In addition, the board does not require the specifically named grantees to provide any certification or documentation relating to their match requirement.

Because the board has not done any independent verification, even on a sample basis, for the natural resources block grant program matching requirement, it cannot be sure that the counties and other local government units met the required match.

Recommendation

- *The board should take steps to verify that the natural resources block grant program grantees meet their legally mandated matching requirements.*

2. The Board of Water and Soil Resources has transferred funds between its various appropriation accounts.

In several instances, the board has spent amounts specified in its appropriation law for a specific program in another program area. The board's biennial appropriation is used to fund its various grant programs, as well as the administrative costs of the agency. The Legislature has included specific dollar amounts within the law for the various grant programs. In several cases, the board used funds from one program to supplement its spending in another program. This is in violation of Minn. Stat. Section 16A.285, which states, "If an amount is specified for an item within an activity, that amount must not be transferred or used for any other purpose."

First, the board used cost share work grant program funds to pay for general service grant costs. The board annually awards general service grants to 11 joint power boards to pay for the salaries of an engineer and conservation technician. In fiscal year 2001, the 11 joint power boards requested a total amount more than the funding available from the general service grant portion of the board's appropriation. As a result, for that year, the board used $101,474 of funds from the cost share work grant program to meet the shortfall in the general service appropriation for the nonpoint engineering base grant.

Next, the board used $75,000 of the soil and water conservation district general service grant funds to pay for a board consultant. Board officials told us that the consultant's work was to benefit all of the conservation districts. To make up for the subsequent $75,000 general service grant shortfall caused by the consultant contract, the board paid each soil and water district a portion of its general service grant from the cost share work grant portion of the appropriation.

Finally, the board did not pay an approved amount to a county for a natural resources block grant. The board added $21,320 to one county's natural resources block grant for inspection and maintenance costs of a ditch system in a watershed. The board added the amount to the county's natural resources block grant instead of awarding a separate grant for the additional project.

Recommendation

- *The Board of Water and Soil Resources should ensure that the grant expenditures meet the requirements of the appropriation law, including compliance with Minn. Stat. Section 16A. 285.*

Chapter 3. Easement Purchases and Conservation Plan Payments

Chapter Conclusions

For the items tested, the Board of Water and Soil Resources' easement expenditures complied with significant finance-related legal provisions, including statutory provisions and appropriation laws. However, the board incorrectly coded easement payments on the state's accounting system.

The Board of Water and Soil Resources administers the Conservation Reserve Enhancement Program to protect environmentally sensitive land and marginal cropland by acquiring easement rights from landowners. The program combines the federal Conservation Reserve Program with the state's Reinvest in Minnesota Reserve Program to partner state and federal resources.

Audit Objectives

We focused our review on the following questions related to the Conservation Reserve Enhancement Program:

- Did the board's internal controls provide reasonable assurance that easement expenditures were accurately reported in the accounting records and in compliance with applicable legal provisions and management's authorization?

- Are easement expenditures in compliance with significant finance-related legal provisions?

Program Background

The board administers the Conservation Reserve Enhancement Program. Qualified landowners receive an up-front payment from the board plus 15 years of guaranteed annual payments from the federal government for approved easements. For the audit period, the board paid approximately $70 million to landowners for easement rights and conservation plan practices. The program receives appropriations from the building fund. These appropriations are available until expended since some easement transactions take several years to complete.

The state enters into easement agreements with eligible landowners that give the state rights to the land. The easement is the formal agreement between the state and the landowner. The landowner receives payment for the land and payment for specific conservation practices that are outlined in an approved conservation plan. The board records its easement financial activities on an internal database and processes its transactions through the statewide accounting system (MAPS).

In addition, the local soil and water conservation district works with the landowner to develop a conservation plan to manage the easement property. The plan generally includes activities such as wetland restoration, native grass plantings, and tree plantings and identifies a maximum amount of landowner reimbursement for implementing the plan. Landowners submit invoices to the board for costs incurred in implementing the conservation plan.

As a result of our audit of easement purchases and conservation plan payments, we identified one issue as discussed below.

3. The Board of Water and Soil Resources incorrectly coded easement payments on the state's accounting system.

The board has recorded an incorrect record date in the state's accounting system (MAPS) for its easement purchases and conservation plan payments. The Department of Finance uses the record date field to determine the state's outstanding liabilities at year-end for financial reporting purposes. The board has been using the date that the accounting unit received the easement agreement or the conservation plan invoice as the record date. However, the state becomes liable for these payments much earlier. In the case of the easement purchases, the state incurs the liability on the date that the landowner completes all of the eligibility requirements relating to the easement. For conservation plan payments, the state incurs the liability when the landowner incurs costs, such as the purchase of seed, or performs the necessary work.

Recommendation

- *The board should use the correct record date when entering easement payments into MAPS.*

Status of Prior Audit Issues
As of April 6, 2004

Most Recent Audit

Legislative Audit Report 01-23, issued in May 2001, covered the three fiscal years ended June 30, 2000. The scope of this audit included easements, grants, federal grant revenue, payroll, and other administrative expenditures. The report included four written findings. We reviewed the status of the two prior findings relating to grants and easements. Two issues were completely resolved. The other two findings related to areas not included in the current audit's scope.

State of Minnesota Audit Follow-Up Process

The Department of Finance, on behalf of the Governor, maintains a quarterly process for following up on issues cited in financial audit reports issued by the Legislative Auditor. The process consists of an exchange of written correspondence that documents the status of audit findings. The follow-up process continues until Finance is satisfied that the issues have been resolved. It covers entities headed by gubernatorial appointees, including most state agencies, boards, commissions, and Minnesota state colleges and universities. It is not applied to audits of the University of Minnesota, any quasi-state organizations, such as metropolitan agencies, or the State Agricultural Society, the state constitutional officers, or the judicial branch.

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July 15, 2004

James R. Nobles, Legislative Auditor
Office of the Legislative Auditor
140 Centennial Office Building
658 Cedar Street
Saint Paul, Minnesota 55155

Dear Auditor Nobles:

This letter is in response to the audit findings letter received from you dated June 30, 2004.

We appreciate the opportunity to respond to the findings and recommendations included in your report covering the three state fiscal years ending June 30, 2003. We found the information in your report and in the exit meeting to be very informative and helpful in our continuing attempts to operate the agency in the best manner for state citizens.

Issue One: Meeting legally mandated matching requirements

A. We disagree with the finding regarding a match on the Joint Powers Board grants. The language in the appropriation regarding grant matching is for the natural resource block grants to counties. The three Joint Powers Board grants in the appropriation are line items that are specific appropriations to these entities and not to counties. All three (St. Louis River Board, Southeast Minnesota River Board, and Minnesota River Board) were in fact matched 1:1 despite our belief that this was not required in the legislation. We are confident that the legislative intent was that these be treated as independent line item appropriations. It should be noted that none of these three grants have continued.

B. We disagree with the assertion that no documentation is requested for grant closeout. The electronic data systems used by grantees, which is the eLINK system and previously was the LARS system, both document expenditures including local match. It is true that we do not require certification of the match. The new eLINK system implemented in FY04 does provide enhanced capabilities that LARS did not. We now understand you are suggesting at least a selective confirmation of how local match is made and we will look at how this might be accomplished within our limited administrative resources.

Issue Two: Transferring funds between appropriation accounts

We disagree with the assertion that the three expenditures noted are a violation of Minn. Stat. Section 16A.285. All the transfers were for the same purpose as the appropriation and therefore do not violate the statute. The provision only disallows transfers or usages for any other purpose. Following are specific additional responses for each expenditure noted:

A. This $101,474 transfer fell within the 20% Technical and Administrative Assistance maximum and is therefore appropriate. MN Stat. 103C.501, which governs cost-sharing contracts, states that remaining cost-share funds may be allocated to districts for not more than 20% technical and administrative assistance. In FY01, the total grants were $4,433,291. Technical and administrative assistance totaled $812,563, or only 18.3%.

B. This transfer falls within the same appropriation language noted in A. The $75,000 counts towards FY03 technical and administrative assistance, which totaled 18%, or within the 20% limitation.

C. We have now obtained legislative language change that will negate the problem you cited with the $21,320 grant. At the time we were attempting to streamline the grant process by consolidating grants where practical. Even with this language, consolidation of the project grant would seem efficient business.

Issue Three: Recording of easement payments

After our exit meeting we now understand the question you are raising about which "Date of Record" to use in the state accounting system MAPS. We are in discussions with the Department of Finance contact you suggested, and will make a decision on what "Date of Record" to use after we review their advice.

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

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

Sincerely,

Ronald D. Harnack
Executive Director