O L A **OFFICE OF THE LEGISLATIVE AUDITOR**
STATE OF MINNESOTA

Financial Audit Division Report

Minnesota Board of Water and Soil Resources

July 1, 2003, through June 30, 2007

November 28, 2007 **07-33**

Financial Audit Division

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

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OFFICE OF THE LEGISLATIVE AUDITOR
State of Minnesota • James Nobles, Legislative Auditor

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O L A
OFFICE OF THE LEGISLATIVE AUDITOR
State of Minnesota • James Nobles, Legislative Auditor

Representative Rick Hansen, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. John Jaschke, Executive Director
Minnesota Board of Water and Soil Resources

Members of the Minnesota Board of Water and Soil Resources

We conducted an audit of the Minnesota Board of Water and Soil Resources for the period July 1, 2003, through June 30, 2007. Our audit scope included grant expenditures, easements, payroll, and other administrative expenditures. Our objectives focused on a review of the board's internal controls over these financial activities and its compliance with applicable legal provisions. In addition, our office conducted a separate audit of professional/technical services at several agencies, including the Minnesota Board of Water and Soil Resources. We report the results from that audit in Chapter 5, Professional/Technical Services Contracts. The Report Summary highlights our overall audit conclusions. The specific audit objectives and conclusions for each area are contained in the individual chapters of this report.

We would like to thank the staff from the Minnesota Board of Water and Soil Resources for their cooperation during this audit.

/s/ James R. Nobles	*/s/ Cecile M. Ferkul*
James R. Nobles Legislative Auditor	Cecile M. Ferkul, CPA, CISA Deputy Legislative Auditor

End of Fieldwork: August 31, 2007

Report Signed On: November 26, 2007

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Audit Participation

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

Cecile Ferkul, CPA, CISA	Deputy Legislative Auditor
Tom Donahue, CPA	Audit Manager
Joan Haskin, CPA, CISA	Auditor-in-Charge
Melanie Greufe	Senior Auditor
Mark Allan	Auditor
Sara Becker	Auditor

Exit Conference

We discussed the results of the audit with the following staff of the Minnesota Board of Water and Soil Resources at an exit conference on November 19, 2007:

John Jaschke	Executive Director
Bill Eisele	Administrative Services Director
Dave Weirens	Land and Water Section Manager

Report Summary

Overall Conclusion:

The Minnesota Board of Water and Soil Resources generally complied with the finance-related legal provisions we tested. However, the board did not have adequate internal controls over certain financial processes.

The report contains 15 findings related to internal control and legal compliance. Our prior audit report (2004) contained three findings. One finding was resolved, while the other two are repeated in this report.

Key Findings:

- The board did not adequately administer its financial management duties. (Findings 1-10, pages 8-15)
- Prior Finding: The board did not ensure that grantees met the legally mandated matching requirements. (Finding 11, page 19)
- The board awarded grants to districts that did not provide comprehensive work plans. (Finding 13, page 20)
- The board did not inspect wetland sites added to the wetland bank. (Finding 14, page 22)
- The board did not prepare performance evaluation reports for completed professional/ technical services contracts as required by statute. (Finding 15, page 26)

Audit Scope

Period Audited:
July 1, 2003, to June 30, 2007

Programs Audited:
- Payroll and other administrative expenditures
- Grant expenditures
- Easements
- Professional/technical services contracts

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. 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 four-year audit period, the board spent approximately $25 million annually.

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Chapter 1. Introduction

The Minnesota Board of Water and Soil Resources (board) operates pursuant to *Minnesota Statutes* 2007, chapter103B. It is responsible for coordinating and supporting the state's local water management entities. These entities include 91 soil and water conservation districts, 46 watershed districts, 23 metropolitan watersheds, and 80 county water management organizations. To support these entities, the board provides technical and administrative assistance, reviews management plans, and distributes grant dollars. The agency also administers the Wetland Conservation Act and carries out several other coordinating functions. Water and soil conservation on private land is the agency's primary focus.

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 nine times per year. Per *Minnesota Statutes* 2007, 103B.101, subd. 4, the board employs an executive director and other staff and gives them the authority to act on behalf of the board. John Jaschke became the board's executive director in January 2007. Ronald Harnack was the previous executive director. The agency's staff members are located in its central offices in Saint Paul and field offices located in Rochester, Mankato, Marshall, New Ulm, Brainerd, Bemidji, Fergus Falls, and Duluth.

Audit Approach

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,[1] as our criteria to evaluate board 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, we gained an understanding of the Minnesota Board of Water and Soil Resources' financial policies and procedures. We considered the risk of errors 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.

[1] The Treadway Commission and its Committee of Sponsoring Organizations was established in the mid-1980s by the major national associations of accountants. One of their primary tasks was to identify the components of internal control that organizations should have in place to prevent inappropriate financial activity.

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Chapter 2. Overall Financial Management: Payroll and Other Administrative Expenditures

Chapter Conclusions

The Minnesota Board of Water and Soil Resources did not have adequate internal controls over its financial management processes:

- ***The board did not adequately fulfill its financial management responsibilities. (Finding 1)***
- ***The board did not adequately monitor payroll transactions. (Finding 2)***
- ***The board could not support the propriety of some of its expenditure transactions. (Finding 3)***
- ***Interagency grants were not properly recorded on the accounting system. (Finding 4)***
- ***The board did not have adequate internal controls over returned grant funds. (Finding 5)***
- ***The board did not review the personal use of state-owned cell phones. (Finding 6)***
- ***The board did not properly identify the date of record for some expenditure transactions. (Finding 7)***
- ***The board erroneously underpaid a retiring employee's health care savings account. (Finding 8)***
- ***The board did not have adequate internal controls to safeguard fixed asset and sensitive items. (Finding 9)***
- ***The board circumvented purchasing controls by not initiating transactions through the procurement component of the state's accounting system. (Finding 10)***

For the items tested, the board generally complied with finance-related legal provisions for payroll and other administrative transactions.

Audit Objectives

Our audit of payroll and other administrative expenditures focused on the following questions:

- Did the board have adequate internal controls to ensure that it accurately compensated employees for work performed, properly authorized and paid payroll and other administrative transactions, and accurately recorded them on the state's accounting system?

- For the items tested, did the board comply with finance-related legal provisions over payroll (including bargaining agreements) and other administrative expenditures?

Financial Management

The staff of the Minnesota Board of Water and Soil Resources manages the operations of the board, including processing grant and easement documents. As of June 2007, the board had 67 employees consisting of 60 full-time and 7 part-time employees. The board's main offices are located in Saint Paul, and it has seven field offices throughout the state.

The board's accounting unit consists of an administrative services director and an accounting officer who are responsible for all of the board's accounting transactions, including recording transactions on the state's accounting system and maintaining documentation of the transactions that support their authorization and appropriateness. It is their responsibility to keep the board in compliance with state policies and procedures. The board lost 1.5 accounting positions in fiscal year 2004 due to budget cuts.

The administrative services director updates the executive director on financial matters monthly at management team meetings. The executive director is involved in the budget process and also approves large expenditures and all out-of-state travel.

Table 2-1 summarizes the board's cash basis payroll and other administrative expenditures for the period July 1, 2003 through June 30, 2007.

Table 2-1
Payroll and Other Administrative Expenditures
July 1, 2003 – June 30, 2007

Expenditure Category	2004	2005	2006	2007
Payroll and Per Diem	$4,464,136	$4,264,128	$4,392,156	$4,784,001
Travel	247,428	251,386	296,854	329,403
Supplies and Equipment	161,943	200,313	113,272	282,696
Space Rental	258,069	197,312	108,864	137,428
Computer and System Services	83,040	124,424	258,082	153,311
Communications	123,123	69,067	71,785	59,808
Other Expenditures	91,837	215,034	153,105	228,537
Total	$5,429,576	$5,321,664	$5,394,118	$5,975,184

Note: Cash basis expenditures are those entered on the accounting system between July 1 and June 30 for each year. The table includes cash basis amounts, because the board's expenditures cross many budget fiscal years.

Source: Minnesota Accounting and Procurement System as of June 30, 2007.

Human Resources and Payroll

The board eliminated its only full time human resources position during 2004. Since May 2005, the board has had an informal arrangement with the Minnesota Pollution Control Agency for its human resources services. Under this arrangement, the Minnesota Pollution Control Agency administered and processed the board's human resources transactions, including transactions related to initial hiring, promotions, performance increases, terminations, resignations, and retirements. The board's administrative services director provides authority for processing personnel transactions and is the authorized contact for requesting human resources assistance. There is no monetary compensation required for providing these services. The board formalized the arrangement with an interagency agreement in June 2007. The agreement has no set expiration date.

In 2004, the board began using the state's self service time entry report to record actual hours worked by employees. Employees entered their hours on-line and then forwarded those hours to their supervisors for review and authorization. On the last day of the pay period, the supervisors electronically approved the hours worked. Payroll included regular, part-time, overtime, and premium pay, as well as other benefits.

Other Administrative Expenditures

In addition to its payroll expenditures, the board spent over $1 million annually for other administrative expenditures, such as rent, supplies and equipment, computer and system services, communications, travel, board per diems, and other operating expenditures during the audit period. This represented about 4.2 percent of total board expenditures.

Travel - The board incurred travel costs for both staff and board members throughout the audit period. These costs totaled $1,125,071 for the audit period or about $281,000 annually. The majority of travel is on program implementation and oversight by all staff that travel. The board reimbursed staff for eligible travel expenses in amounts allowed in the bargaining unit agreements. Board members were also eligible for travel costs incurred as a result of their service on the board, including meals, lodging, and private car mileage. *Minnesota Statutes*[2] that regulate board compensation also generally allowed board members to receive per diems.

Supplies and equipment - The board purchased various office supplies and equipment, generally from the Central Stores Division of the Department of Administration, to support board operations, including items shipped to the various satellite offices throughout the state.

Space rental – The board rented office space in Saint Paul for its main office operations. The board also rented space for seven field offices.

Computer and system services - The board purchased computer software, software upgrades, license fees, and maintenance to support board operations for all eight of the board's offices.

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[2] *Minnesota Statutes* 2007, 15.0575.

Minnesota Board of Water and Soil Resources

Communications **–** The board's main communications expenditure was for network services including wired and cell phone service, fax and pager charges, and computer communications. Board and state policy requires employees to reimburse the state for the cost of personal cell phone calls. Communications also included postage and mail and delivery services costs.

Other expenditures **–** These generally included repairs, printing and advertising, and employee development.

The board had the following weaknesses in its overall financial management and in its payroll and other administrative expenditures areas:

Current Findings and Recommendations

1. The board did not adequately fulfill its financial management responsibilities.

As explained in more detail in findings 2 through 10, the board had weaknesses in various elements of its financial management duties. In several cases, it lacked documentation to support, explain and justify specific transactions. It also did not always correctly record transactions on the state's accounting system or use appropriate modules of the system to process transactions. It did not have an adequate process to safeguard, deposit, or accurately record receipts. It did not adequately monitor its payroll transactions or employees' personal use of state cell phones. Finally, it did not establish adequate inventory controls for fixed assets and sensitive items.

In aggregate, these weaknesses show an overall lack of proper administrative oversight. Many of these weaknesses resulted from insufficient understanding of state and agency policies and procedures and a lack of attention to detail by those with financial management responsibilities.

Recommendation

- *The board needs to examine its operations and provide adequate training and oversight to its accounting personnel to ensure that it adequately performs its financial management responsibilities.*

2. The board did not adequately monitor payroll transactions.

Board staff did not review key reports to ensure the accuracy of payroll transactions.

- The board did not review a payroll report that evaluates data entered through the state's self service time entry process. The administrative services director stated that he was not aware of this report or the state policy requiring the review.[3] The integrity of the state's self service time entry process depends on employees completing their own timesheets and their primary supervisors authorizing the hours for payment. The report

[3] Department of Finance policy PAY0017.

identifies transactions that bypassed these fundamental assumptions: It identifies timesheets not completed by the employee or not approved by the employee's primary supervisor.

For seven pay periods tested, the self service time entry audit report identified 70 timesheets not completed by the employee, 160 timesheets authorized by a back up approver (including a Duluth employee designated as a back up approver for employees located in the Twin Cities area), and 7 employees who approved their own timesheets. The policy requires the board to resolve any exceptions noted on the report. For each of these exceptions, the board should have validated the reported hours with the employee or the primary supervisor, as appropriate, and should have considered changes in its designations of primary and back up approvers. The board should have questioned back up approvers with no direct knowledge of the work performed and arrangements that allowed employees to authorize their own timesheet.

- In addition, the board had no evidence that it reviewed another important payroll report, the payroll register, as required by state policy.[4] This report shows all biweekly payroll transactions, including current and retroactive salary adjustments, special lump-sum transactions, and changes to earning types, hours, and pay rates. The policy requires the board to independently verify that the transactions are correct and authorized.

  The board made some incorrect payments that it could have detected by a careful review of the payroll register and comparison to the supporting documents, such as timesheets. The board incorrectly paid two employees holiday pay instead of vacation pay. The employees received 16 hours and 18 hours of holiday pay, respectively. A careful review of the payroll register would have identified these payments for holiday pay as unusual, since they occurred in pay periods when no holidays occurred. In addition, the board did correctly allocate one employee's time in accordance with an interagency agreement. The employee noted on his timesheet that the board should charge 15 hours of his time to another agency; however, the board only charged eight hours to the other agency. A comparison of the hours recorded on the payroll register to the employee's timesheet would have identified this error.

In the state's payroll process, an agency's key responsibility is to ensure that the state pays for hours worked and records the transactions accurately in the accounting records. Without reviewing these key reports, the board cannot demonstrate that it has fulfilled its duties and complied with state payroll policies.

Recommendations

- *The board should review self service time entry audit reports and the payroll register and document the resolution of exceptions noted.*
- *The board should periodically review its designations of primary and backup approvers for the state's self service payroll system.*

[4] Department of Finance policy PAY0028.

3. The board could not support the propriety of some of its expenditure transactions.

The board did not have documentation to support some expenditure transactions, including a large expenditure correction, some training expenditures, internal authorizations for purchases, and rent payments.

- The board did not have supporting documentation for an expenditure correction of $1.6 million recorded on the state's accounting system. During our audit, board staff did not know why the correction was made and could not explain it.

- The board did not have adequate documentation for $1,225 identified as training on the state's accounting system. Although it had documentation about the training event, including its dates, times, and a registration form, the board did not document which employees attended the training.

- The board did not have any documentation for $889 paid to an outside vendor. The board reimbursed the vendor $550 for travel expenses and $339 for per diem. Board staff were unable to explain or justify the propriety of the payments.

- The board could not document its claim that the Minnesota Pollution Control Agency had waived the board's rent payments. Board staff stated that it had an informal agreement with the Minnesota Pollution Control Agency to not pay rent for fiscal year 2006. The only evidence of this agreement was a post-it note, dated and signed by the board's administrative services director, stating that the commissioner of the Minnesota Pollution Control Agency had given the board a one year rent waiver. The formal interagency rent agreement did not include a waiver for the first year and stated that the board shall pay as invoiced. The Minnesota Pollution Control Agency had invoiced the board $17,404 for rent for the period October through December 2005. The rent schedule in the interagency agreement showed total rent due for fiscal year 2006 as $69,614.

- The board had not paid rent to the U.S. Department of Agriculture for office space in Fergus Falls from October 2004 through June 2007. The lease with the U.S. Department of Agriculture extends through September 2008. Although the board still occupied the space and the lease had not been cancelled, board staff said they have not received any invoices to pay. Board staff had not inquired about the lack of invoices or attempted to make required rent payments.

- The board did not have lease agreements on file for some space rented in out-state Minnesota. The only supporting documentation for rent payments made to Chippewa County was a post-it note stating the rent amount. Payments to the county totaled about $2,700. The only documentation on file for some payments for space rented in Brainerd was a memo to the tenants (including the board) stating that the rented space had a new owner, and future rent payments should be paid to him.

The lack of adequate documentation increases the risk that unauthorized or inappropriate transactions could occur and not be detected.

Recommendation

- *The board should ensure that it adequately documents its transactions and the details of its agreements with other state agencies or outside entities and that it makes payments in accordance with those agreements.*

4. Interagency grants received from the Minnesota Pollution Control Agency were not properly recorded on the accounting system.

The board incorrectly recorded $2.3 million in grant funds disbursed to counties on behalf of the Minnesota Pollution Control Agency through an interagency agreement. Under the agreement, the Minnesota Pollution Control Agency determined county eligibility and the amount of the grant award under its county feedlot grant program. Because of the board's existing grant relationships with the counties, it prepared and executed the contracts with each county and disbursed the grant funds.

The receipt of the grant funds from the Minnesota Pollution Control Agency were recorded as "state agency reimbursements." The transaction recorded the receipt on the state's accounting system as a negative expenditure, offsetting the subsequent grant expenditures. As a result, the board's revenue and grant expenditures were both understated.

The board should have established a separate appropriation account in the state's accounting system for the funds received from the Minnesota Pollution Control Agency.

Recommendation

- *The board should work with the Minnesota Pollution Control Agency to record interagency grant funds in a separate appropriation account on the accounting system.*

5. The board did not have adequate internal controls over returned grant funds.

The board did not have good internal controls for unspent grant funds returned from local units of government. The board did not separate duties over grant funds returned to the board, did not always post the funds to the credit of the right county, and did not deposit the funds promptly as required by statute. Returned grant funds from fiscal years 2004 through 2007 totaled $2.9 million.

The board did not separate incompatible duties in its process for returned grant funds. The accounting officer received the checks, prepared the deposit, and recorded the refunds on the state's accounting system. These duties are incompatible because they allow one employee to control the entire process. By not separating these incompatible duties, the board increases the risk that errors or irregularities could occur and go undetected.

The board recorded an $82,500 check for grant funds not spent by Winona County to the credit of Wright County. In addition, the board posted approximately $19,000 of returned unspent grant funds from five different districts to the credit of Martin County. Accurately recording returned grant funds is an important part of the board's administrative responsibilities.

The board did not deposit cash receipts over $250 daily, as required by statute.[5] In seven instances, receipts ranging between $331 and $64,706 were not deposited in a timely manner. The accounting officer kept the checks in her locked drawer until they were deposited.

Recommendations

- *The board should separate duties for returned grant funds to ensure that one person does not have both physical custody of the checks and record keeping responsibilities.*

- *The board should accurately record returned grant funds to the credit of the correct local unit of government.*

- *The board should deposit cash receipts over $250 on a daily basis, as required by statute.*

6. The Board of Water and Soil Resources did not review the personal use of state-owned cell phones.

The board did not monitor and review cell phone bills for staff. In addition, the board did not annually review an employee's business need for a cell phone nor assess the cost/benefit of the arrangement. The board provided 34 employees with state-owned cell phones.

The board's accounting officer gave the employees copies of the cell phone bills and asked them to annually reimburse the board for any personal calls. The accounting officer said that only one employee reimbursed the board in fiscal year 2007. There was no documentation that any of the other employees reviewed the bills or noted any personal use of the cell phones. One employee stated that he was advised that reimbursement was not necessary if there were only isolated personal calls (a minute here or there) on the bill.

Department of Administration policy regarding state-owned cell phone use states that all personal use of a state-owned cell phone, whether essential and nonessential personal calls, shall be identified by employees and submitted monthly to their supervisor or other employees assigned to review and approve the monthly cell phone bill. The use of state-owned cell phones is intended for state business. Personal use of state-owned cell phones is prohibited except for

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[5] *Minnesota Statutes* 2007, 16A.275.

essential personal calls. State policy requires employees to reimburse the state within 30 days for the cost of nonessential personal calls[6] at the state's cost.

The policy also states that state agencies should conduct an annual review of the individual cell phone assignments to determine if there is a continuing need for cell phones and if the cost is justified. The board could not demonstrate that it was performing the annual cell phone review.

Recommendations

- *The board should monitor and review the cell phone billings for staff on a monthly basis.*

- *The board should annually review its cell phone assignments to determine the need for them and if the cost is justified.*

7. Prior Finding Not Resolved: The board did not properly identify the liability date for some expenditure transactions.

The board did not properly record the date the state incurred a liability for some expenditure transactions. The board had an incorrect record date in the state's accounting system in over 80 percent of the 76 sample items tested. For 36 of the 76 items tested, the board had recorded a record date that was inconsistent with documentation supporting the transaction. In addition, for 27 of the 76 sample items tested, the board lacked documentation indicating the correct record date.

The board also used incorrect record dates in the state's accounting system for some easement purchases. The board stated that it used the date the Attorney General's Office gave its approval of the easement; however, the board did not consistently use that date. Five of fourteen sample items tested had the incorrect record date. Sometimes the board used the date the county recorded the easement, the date the board received documentation from the soil and water conservation districts, or the date the board approved the easement and sent to the Attorney General's Office for review.

The Department of Finance requires agencies to use the accounting system's record date to indicate when goods or services are received to determine in which period the accounting system should recognize transactions. If the agency uses an incorrect record date, the transactions may accrue to the wrong fiscal year and cause a misstatement in financial statements.

[6] Essential personal calls are those that are of minimal duration and frequency and are urgent in nature and cannot be made at another time or from a different phone.

Recommendation

- *The board should properly identify all transactions' record dates in the state's accounting system.*

8. The board erroneously underpaid a retiring employee's health care savings account.

The board did not properly pay about $16,200 of vacation and severance[7] for its former executive director into a health care savings account, as required by the applicable bargaining agreement. Instead, the board paid the former executive director about $2,700 to liquidate his vacation balance, and only paid half of the $27,000 severance payment into his health care savings account. Almost four months later, the Department of Finance paid the other half of the severance pay-out to the health care savings account.

Under a bargaining agreement effective July 1, 2006, the board should have paid the vacation and severance payouts directly into the employee's health care savings account.

The board is responsible for correctly calculating vacation payouts and severance payments as a result of retirements and employee departures. Because these are manual calculations based on bargaining agreement terms, the board's process should include independent verification that its staff has accurately determined the payout amounts and correctly interpreted the applicable requirements.

Recommendation

- *The board should independently verify the accuracy of its vacation and severance payout amounts, and deposit the payouts to the individual health care savings account according to the bargaining agreements.*

9. The board did not have adequate inventory controls for fixed assets and sensitive items.

The board did not have a complete list of its fixed assets and sensitive items, such as cell phones and GPS equipment. The board maintains two fixed asset lists; the Finance Division maintains one list and the Information Technology Division maintains another. However, four of seven sample items tested were not on either asset list. One of the unrecorded assets was $10,239 of computer equipment.

In addition, the employee who maintains the information technology asset list is the person who conducts the physical inventory. These duties are incompatible because they allow the employee to check the accuracy of his/her own work. Good internal control practices require that the board

[7] Severance payments are 40 percent of accrued sick leave hours for the first 900 hours of sick leave plus 12 ½ percent for hours over 900 hours, at the employee's current hourly pay rate.

either separate incompatible duties or develop effective controls to mitigate the risk. Additionally, state guidelines state that it is essential that the person taking the physical inventory counts is not the same person responsible for reporting activity in the inventory system.

Without an accurate inventory of fixed assets and sensitive items and an independent verification of the existence of those assets, there is greater risk that theft or errors could occur and not be detected.

Recommendations

- *The board should ensure that its fixed assets and sensitive items inventory lists are complete and accurate.*

- *Someone independent of maintaining the inventory list should conduct the physical inventory.*

10. The board circumvented purchasing controls by not initiating transactions through the procurement component of the state's accounting system.

The board did not use the procurement component of the state's accounting system to initiate 19 of 48 expenditure transactions tested. As a result, the board did not generate a purchase order or an encumbrance in the accounting system. It also avoided a system required "three way match" that validates the purchase order to the goods received and the invoice before payment. The state designed these controls into the procurement component of the accounting system to ensure that an agency has sufficient funds for its obligations, and that it only pays for authorized purchases and goods actually received. By circumventing these controls, the board increases the risk that its obligations exceed its resources, and that it pays for unauthorized expenditures or goods or services not received.

Recommendation

- *The board should use the accounting system's procurement component when purchasing goods or services.*

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Chapter 3. Grant Expenditures

Chapter Conclusions

The Minnesota Board of Water and Soil Resources generally had adequate internal controls over grant expenditures; however, the board did not perform closeout procedures for some grants (Finding 11). In addition, the board did not ensure that grantees met the legally mandated matching requirements (Finding 12).

For the items tested, the grant contracts and proposed grantee spending were in accordance with the intent of the appropriation laws, and grant expenditures were in accordance with related grant agreements. However, the board awarded grants to certain districts even though the district had not submitted a required comprehensive work plan (Finding 13).

Audit Objectives

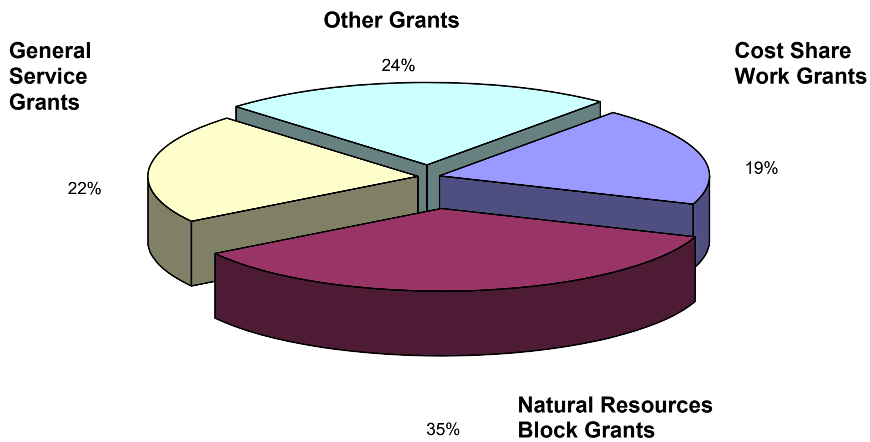
Our audit of grant expenditures addressed the following questions:

- Did the board have adequate internal controls to ensure that it accurately reported grant expenditures in the accounting records and complied with applicable legal provisions and management's authorization?
- Did the board comply with grant agreements and other state grant requirements?
- Were the grant contracts and proposed grantee spending in accordance with the intent of the appropriation or source of funding?
- Did the board monitor grantee activities to ensure compliance with the terms of the grants?

Background

The board awarded grants for financial, technical, and administrative assistance for conservation, erosion control, and water quality management practices and programs. The largest grant programs included natural resources block grants, general services grants, and cost share work grants. Other grants included clean water legacy, farmbill aid, and local water management challenge grants. The board awarded most of its grants to local units of government, primarily counties, soil and water conservation districts, and watershed districts. Grant expenditures totaled approximately $16.3 million annually during the audit period and are shown by appropriation category in Figure 3-1.

Figure 3-1
Grant Expenditures
July 1, 2003, through June 30, 2007



Source: Minnesota Accounting and Procurement System, budgetary fiscal years 2004 through 2007, as of June 30, 2007.

The board employed 16 conservationists, trained in education and conservation, to work with the grantees out of the eight field offices. Their responsibilities included reviewing grant applications, grantee budget and financial reports, and determining whether unallocated grant funds exist and must be returned to the board.

Natural Resources Block Grants

The board awarded natural resources block grants to counties for comprehensive local water plan and wetland conservation act implementation. Through these grants, the board also distributed Department of Natural Resources' shoreland management funds, as well as the Minnesota Pollution Control Agency's feedlot permits and sewage treatment funds. Counties could apply for any or all of the programs. Counties initiated the application process to request funds under the block grant beginning in July. Although the grant agreements covered a two-year period, counties could apply for each grant on an annual basis. To participate, the board required a county to submit a comprehensive work plan, provide a resolution authorizing a required match, and submit an annual report to the board.

The board determined the awards for the local water planning and wetland conservation act portions of the program based on a formula. The Department of Natural Resources determined the awards for the shoreland management grant. The Minnesota Pollution Control Agency determined 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.

Minnesota Board of Water and Soil Resources

Cost Share Work Grants

Cost share work grants provided 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 implemented practices to protect and improve soil and water resources, such as strip cropping, terraces, storm water control systems, and field windbreaks. These grants included the following programs: cost-share base grants 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.

The state's 91 soil and water conservation districts were all eligible for the base grant, as long as the board had 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, allowing the board to adjust a district's future grants based on past performance. The board determined the funding for special projects and feedlot grants on a competitive basis according to a priority system.

General Service Grants

The board provided 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 provided nonpoint engineering to support the salaries of a district engineer and technician. To qualify for this grant, each district submitted an annual plan, comprehensive plan, and an annual report. In addition to the general services portion, a soil and water district could 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 applied for this grant and acted as fiscal agents for the local districts.

The board had the following weaknesses in its grant administration process:

Current Findings and Recommendations

11. Prior Finding Not Resolved: The board did not ensure that grantees met the legally mandated matching requirements.

The board did not ensure that counties and other local units of government receiving certain natural resources block grant program funds had met the legally required match.[8] The board did not require the grantees to provide supporting documentation that the match was met. In addition, the board's conservationists do not review documentation relating to the match, even on a test basis, as part of their grant closeout procedures. Instead, the board anticipated that the match would be met based on signatures of county officials on the allocation and contribution plans, which state, "By signing below, we are agreeing to expend grant funds, match and provide documentation for the match in the amounts listed above."

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[8] *Laws of Minnesota*, 1st Special Session 2005, chapter 1, article 2, section 5.

The appropriation 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.

Recommendation

- *The board should verify, on a test basis, that natural resources block grant program grantees meet the matching requirements of the program or change the grant provisions requiring the match.*

12. The board did not perform closeout procedures for some Cost Share Work Grants.

The board did not perform closeout procedures for 3 of 14 soil and water conservation districts tested who received Cost Share Work grants totaling about $534,000. The grant funds were no longer available and the grant period had ended. According to the board's policy, the board is required to prepare closeout reports when the cost share work project has been completed. Without performing a closeout of the grant, the board cannot determine that funds were spent appropriately or determine if funds not spent are due back to the state. In addition, performance criteria that affect subsequent grants to the soil and water conversation district cannot be accurately monitored.

Recommendation

- *The board should perform closeout procedures on all of its Cost Share Work Grants.*

13. The Board of Soil and Water Resources awarded grants to districts that did not provide comprehensive work plans.

The board awarded grants to three Soil and Water Conservation Districts that did not provide a comprehensive work plan to the board. To continue to receive certain types of grants, the districts needed to present the board with either their comprehensive work plan or a resolution to adopt their respective county's comprehensive work plan. Board policy stated that no further funds were to be awarded to districts that did not have a plan on file. One district received additional funding of $395,000 for several grants although it had not submitted the required plan. Two other districts received General Service Grants of $30,609 and $24,039 without having a plan on file with the board.

Recommendation

- *The board should ensure that it awards grants only to districts that have a comprehensive plan on file.*

Chapter 4. Easements and Conservation Plan Payments

Chapter Conclusions

The Minnesota Board of Water and Soil Resources accurately recorded easement expenditures in the state's accounting system, except that it used incorrect dates to record the date of liability, as discussed in Chapter 2, Finding 7.

For the items tested, the board's easement expenditures complied with significant finance-related legal provisions, including statutory provisions and appropriation laws. However, as explained in Finding 14, the board did not monitor its wetland banking sites.

Audit Objectives

Our audit of easements and conservation plan payments addressed the following questions:

- Did the board accurately record easement expenditures in the state's accounting system and in compliance with applicable legal provisions, appropriation laws, and management's authorization?

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

Background

Reinvest in Minnesota/Conservation Reserve Enhancement Program

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. During fiscal years 2004 through 2007, the board paid approximately $4.7 million annually to landowners for easement rights and conservation plan practices. The program received appropriations from the building fund. These appropriations were available until expended since some easement transactions take several years to complete.

The state entered into easement agreements with eligible landowners that give the state rights to the land. The easement was the formal agreement between the state and the landowner. The landowner received payment for the land and payment for specific conservation practices that were outlined in an approved conservation plan. The board recorded its easement financial activities on an internal database and processed its transactions through the state's accounting system.

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

The Minnesota Wetland Bank

Minnesota Statutes[9] require that new wetlands be established before or concurrently with the destruction of existing wetlands. To accomplish this, the board set up a process to allow a person wishing to drain or fill a wetland to purchase[10] wetland credits from someone who has already restored or created a wetland. The board administered the Minnesota Wetland Bank to track "deposits" of restored or created wetlands and "withdrawals" of destroyed wetlands.

In addition to administering the wetland bank, the board established agreements with landowners to bank its own wetland credits. The agreement contained a schedule of payments due to a landowner based on the amount of work completed to return the area to wetland status. As a landowner completed the required work, they contacted the board for a scheduled payment. After a satisfactory site inspection, the board paid the landowner for the portion of restoration completed.

The board had the following weaknesses in its easement process:

Current Finding and Recommendations

14. The Board of Water and Soil Resources did not inspect wetland sites added to the wetland bank.

Since 1998, the board had not conducted inspections of wetlands added to the wetland bank. In addition, the board had not tracked which wetlands are due for monitoring or established criteria for the inspections. According to *Minnesota Rules,* 8420.0610, wetland account owners are required to file an annual monitoring report for a five-year period. After that time, *Minnesota Rules*[11] require the board to inspect wetlands deposited into the wetland bank at least once every five years. Without the inspections, the board cannot ensure that the wetlands conform to the conditions specified in the approved banking plan or determine whether any restorative action is needed.

[9] *Minnesota Statutes* 2007, 103G.221.
[10] The purchase of wetland credits is a private transaction between the owner of the credits created by restoring or creating a wetland and the buyer of the credits needed when a wetland is destroyed.
[11] *Minnesota Rules* 8420.075, subpart 2B.

Recommendations

- *The board should develop a tracking system for wetlands that have been added to the wetland bank so that each wetland is inspected at least once in a five-year period.*

- *The board should conduct an inspection of the wetlands in the wetland bank once every five years.*

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Chapter 5. Professional/Technical Services Contracts

Chapter Conclusions

For professional/technical services contracts, the Minnesota Board of Water and Soil Resources' internal controls provided reasonable assurance that the board paid for contractual services actually received, that amounts paid were reasonable and within the terms of the contract, and that the payments were accurately recorded in the accounting system.

For the items tested, the board complied with finance-related legal provisions except that for completed contracts exceeding $50,000, it did not prepare performance evaluation reports or submit the report to the Department of Administration as required by statute.

Audit Objectives

The primary objectives of our audit of professional/technical services contracts were to answer the following questions:

- Did the board's internal controls provide reasonable assurance that the board paid for contractual services actually received, that amounts paid were reasonable and within the terms of the contract, and that payments were accurately recorded in the accounting system?

- For the transactions tested, did the board comply with significant finance-related legal provisions, including bidding requirements?

Background

Professional/technical services represent services that are intellectual in nature and include consultation, analysis, evaluation, prediction, planning, programming, or recommendation and result in the production of a report or completion of a task. Generally, agency personnel are unable to perform the needed services, and the agency must contract with outside vendors.

Minnesota Statutes gives the commissioner of Administration broad authority to oversee and approve the professional/technical contracts entered into by state agencies. Consequently, for contracts over $5,000, the board submits certain information to Administration before contracts are executed, including a certification that the work is necessary to advance the mission of the board, that state personnel are unable to provide the services, an explanation of how the proposed contract will be publicized, and how the board plans to manage the contract. State agencies also must submit performance evaluation reports to the Department of Administration at the completion of contracts exceeding $50,000.

The commissioner of Administration can delegate contracting duties to specific employees in other state agencies; however, board employees do not have delegated authority. Therefore, employees of Administration authorize the board's professional/technical services contracts.

In fiscal year 2006, the board spent $716,000 for professional/technical services contracts. Of the total amount, about $340,000 was spent on general management and fiscal services and the remainder on other types of contractual services. The board acts as project manager and/or fiscal agent for contracts authorized by the Legislative Citizen Commission on Minnesota Resources (LCCMR) and funded from the Environmental and Natural Resources Trust Fund.[12] LCCMR is exempt from *Minnesota Statutes* 2007, 16C. The majority of the board's fiscal year 2006 contract expenditures were for LCCMR contracts.

Based on the board's professional/technical expenditures during fiscal year 2006, we selected the following four contracts for testing. We selected the contracts by taking into consideration dollar amount, object code, and type of contract, such as professional/technical services contract, master contract, sole source, annual plan, etc.

Contracts Selected for Audit

Contractor	Contract Amount	2006 Expenditures
Linnett Geomatics	$ 75,000	$ 74,984
Gary B. Walton	10,000	10,000
Blue Earth River Basin Initiative[1]	403,150	186,122
University of Minnesota[1]	218,850	53,303
Total	$707,000	$324,409

[1]Legislative Citizen Commission on Minnesota Resources contract.

Our audit of professional/technical contracts identified the following issue.

15. The board did not prepare performance evaluation reports for completed professional/technical services contracts as required by statute.

The board did not complete the required performance evaluation reports for two of four contracts tested. The contract with Linnett Geomatics exceeded $50,000 and, therefore, required a performance evaluation report be submitted to the Department of Administration. Board employees were unfamiliar with the following statutory provision. *Minnesota Statutes* 2007, 16C.08, subd. 4(c), requires that within 30 days of final completion of a contract over $50,000, the head of the agency entering into the contract must submit a one-page report to the commissioner of Administration who must submit a copy to the Legislative Reference Library.

[12] *Laws of Minnesota* 2003, chapter 128, article 1, section 9.

Minnesota Board of Water and Soil Resources

The report summarizes the purpose of the contract, the amount spent on the contract, and includes the written performance evaluation. The evaluation reports are intended to provide other state agencies with useful information when evaluating future proposals submitted by the contractor.

Although the board did not complete a performance evaluation for its contract with Gary B. Walton for $10,000, as required by *Minnesota Statutes* 2007, 16C.08, subd. 4a, the requirement was repealed during the 2007 legislative session.[13]

Recommendation

- *For contracts over $50,000, the board should complete the performance evaluation report and submit a copy to the Department of Administration.*

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[13] *Laws of Minnesota* 2007, chapter 148, article 2, section 84.

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Status of Prior Audit Issues
As of August 31, 2007

Most Recent Audit

Legislative Audit Report 04-30, issued in July 2004, covered the three fiscal years ended June 30, 2003. The scope of this audit included grants and easements. The report included three written findings. One finding, concerning transfers between appropriation accounts, was completely resolved. We repeat two of the findings in this report about incorrect liability dates in the state's accounting system for certain types of expenditures (Finding 7) and concerning the board's need to verify that grantees satisfied match requirements (Finding 11).

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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Minnesota Board of Water & Soil Resources

November 21, 2007

Thomas Donahue, CPA
Audit Manager
Office of the Legislative Auditor
Room 140 Centennial Building
658 Cedar Street
Saint Paul, Minnesota 55155-1603

RE: Minnesota Board of Water and Soil Resources Audit for FY04-07

Dear Mr. Donahue:

The Board of Water and Soil Resources' (BWSR) written responses to the findings and recommendations in the FY04-07 audit are as follows:

1. The board did not adequately fulfill its financial management responsibilities.
BWSR agrees with this finding. The restoration of an administrative position as of November 14, 2007 will allow us to re-establish the separation of duties that we had in the past. The Administrative Services Director will be responsible for implementing separation of duties and other control procedures. In addition, we will take steps to improve communication to staff on State policy issues, for example, on cell phone usage. The combination of efforts in these two areas will help us address the issues raised in the audit. State government is in a transitory period involving transfer of information and documentation from paper mode to electronic mode, but we need to keep in mind the importance of proper documentation during the transition.

2. The board did not adequately monitor payroll transactions.
BWSR agrees with this finding. The restoration of the aforementioned staff position in the fiscal services area will allow us to separate duties and dedicate one person to the review process. We agree that the payroll reports (the self service time entry audit report and the payroll register) should have been reviewed and then marked as reviewed by the manager who supervises the accounting staff (Administrative Services Director). With the additional position, we have already instituted a process so that each payroll period report is reviewed. We have reviewed the approval process for self service time entry and when there is a personnel change we will conduct reviews as necessary.

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3. The board could not support the propriety of some of its expenditure transactions.
BWSR agrees with this finding. For bullet 1: We will require approval for entries of this type plus a paper trail, although the lack of documentation for the example cited did not affect the proper disbursement, use and oversight of these funds. For bullets 2 and 3: We agree that this documentation should be retained. We believe the approval process we have will prevent this problem from happening again. Bullet 4: This was an unusual situation where two agency heads made an agreement but we acknowledge that in the future such arrangements made between agencies need to have proper documentation. Bullet 5: We have made the proper billing to U.S. Department of Agriculture for the back rent payment and the rent has been paid. We tried to pay the rent after repeatedly not receiving invoices and that check was returned. The Administrative Services Director will confirm monthly that all rents are paid. Bullet 6: We have obtained the necessary missing paperwork in the Chippewa Falls file from Real Estate Management. We don't believe the documentation in the Brainerd file was lacking.

4. Interagency grants received from MPCA were not properly recorded on the accounting system.
BWSR disagrees with this finding. As pointed out during the audit review, the Department of Finance will not allow us to set up a separate appropriation when there is no appropriation. This is an interagency transfer of funds. We have asked the MPCA to send BWSR the funds as an interagency transfer but they insist on using the "reimbursement" object code method. We cannot control how the MPCA sends funds to BWSR. We share your concern with how this ends up looking in MAPS, although it does not affect the proper disbursement, use and oversight of these funds.

5. The board did not have adequate internal controls over returned grant funds.
BWSR agrees with the finding but not the entire characterization. The first issue raised is not a control issue but rather an issue of human error in encoding. We have added two steps in the processing and review process that should catch any future posting errors of return grant dollars. First, the process for deposits will now have two persons involved. Second, instead of just fiscal staff being involved, the Grants Coordinator now reviews returned funds so that a posting error is more likely to be spotted. Since the returned funds are pooled into one account until they are re-designated, the error did not affect the proper re-disbursement, use and oversight of these funds.

The second issue raised we agree with. The addition of the fiscal staff person will allow us to; (1) separate the deposit duties, and (2) deposit checks more timely. We agree with the importance of this issue but have been limited by having only one fiscal staff person for the past three years. Adjustments to workload priorities should prevent a recurrence and it is the responsibility of the Administrative Services Director to monitor staff to make sure deposits have been made.

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We expect that training on the above should be completed within 30 days and the changes fully implemented.

6. The Board of Water and Soil Resources did not review the personal use of state-owned cell phones.
BWSR agrees with the finding regarding adherence to State policy on cell phone use, however we do require a review cell phone bills. We acknowledge the primary finding is that BWSR did not adequately follow-up to ensure that personal use of cell phones is reimbursed. We had a good system in place when we used "paper" employee expense claims and employees regularly subtracted their cell phone usage from their expense claims. However, once BWSR moved to the state electronic expense claim system, we lost the ability to simultaneously have employees make those adjustments to their claims. The Executive Director has now mandated that all employees with a state cell phone will be required to report monthly on their usage, either with a check attached or a notation that they do not owe anything. We will have this policy in place within 30 days.

7. Prior Finding Not Resolved: The board did not properly identify the liability date for some expenditure transactions.
BWSR has adopted the liability date as the Attorney General's Office dating of the approval of the easement. The processor has been using the "AG date" for the past year and therefore no further changes are necessary.

8. The board erroneously underpaid a retiring employee's health care savings account.
BWSR was following instructions from the State's central payroll operator (Department of Finance) when this payroll entry was processed. We acknowledge that review by the Administrative Services Director, questioning the instructions and researching the collective bargaining agreement could have caught the error. The remedy is to require that all termination payouts be reviewed by the Administrative Services Director, a requirement that has already been instituted.

9. The board did not have adequate inventory controls for fixed assets and sensitive items.
BWSR agrees with the findings and recommendation. We have determined that in order to have independent review, we will make managers responsible for the review process. The Administrative Services Director is responsible for ensuring that the inventory list is updated and the process put in place to ensure independent review. We expect this process to be completed by the end of March 2008.

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10. The board circumvented purchasing controls by not initiating transactions through the procurement component of the state's accounting system.
BWSR agrees with this finding. The accountant had been taught by her predecessor that a few particular types of purchases were to be done in the accounting system. Once the auditor pointed out the error in this reasoning, the practice was corrected. The accountant understands there are no exceptions and further action is not needed.

11. Prior Finding Not Resolved: The board did not ensure that grantees met the legally mandated matching requirements.
BWSR agrees with this finding. The BWSR has recently established a Grants Compliance project team. The team will be exploring options to ensure that grantees meet the legally mandated matching requirements. The possible approaches include:

1. Verifying on a test basis that NRBG grantees meet the matching requirements of the programs.
2. Evaluating policy adjustments to the legislative match requirements.
3. Verifying match requirements via the State Auditor during regular LGU audits.

A match verification process is proposed to be adopted by the BWSR beginning with the FY 09 grant cycles. The Land and Water Section Manager is responsible for resolution of this finding.

12. The board did not perform closeout procedures for some Cost Share Work Grants.
BWSR agrees with this finding. The field staffing deficit contributed to this finding. Regional Supervisors and the Grants Coordinator will notify applicable field staff of needed closeouts and monitor progress beginning January 1, 2008. The Land and Water Section Manager in concert with Regional Managers is responsible for resolution of this finding.

13. The Board of Water and Soil Resources awarded grants to districts that did not provide comprehensive work plans.
BWSR agrees with this finding. A checklist of grant eligibility prerequisites will accompany grant agreements to ensure requirements have been met before grant agreements are executed beginning with the FY 09 grant cycles. The Land and Water Section Manager is responsible for resolution of this finding.

14. The Board of Water and Soil Resources did not inspect wetland sites added to the wetland bank.
BWSR agrees with this finding. A staffing deficit contributed to this finding. Board staff began inspecting bank sites in FY08 and began to develop forms, protocols, and procedures for follow-up when violations of easement terms are identified. These bank inspections serve to comply with the requirement of Minnesota Rule 8420.0750, subd. 2 to inspect bank sites every five years.

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Staff will develop a tracking system this fiscal year to ensure that bank sites are inspected as required by rule. The Land and Water Section Manager is responsible for the follow-up to address this finding.

15. The board did not prepare performance evaluation reports for completed professional/technical service contracts as required by statute.
BWSR agrees with this finding. The accounting coordinator and the Administrative Services Director are now responsible for monitoring this requirement. We have contacted the Department of Administration to conduct training for all our managers who administer professional/technical contracts and this will be one item covered in the training. We had the training set up previously but had to reschedule. The Administrative Services Director is responsible for ensuring that this finding is not repeated and that the training will be scheduled no later than the end of the first quarter in 2008.

Finally, I want to acknowledge the high level of professional and personal conduct of the OLA staff over the several months the audit work was ongoing. If you have any questions, please feel free to contact me.

Sincerely,

John Jaschke
Executive Director

cc: Randy Kramer, BWSR Board Chairman
Bill Eisele, BWSR Administrative Services Director
David Weirens, BWSR Land and Water Section Administrator

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