



OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

FINANCIAL AUDIT DIVISION REPORT

**Board of Water and Soil
Resources and the
Pollution Control Agency**

Clean Water Fund Expenditures

**Internal Controls and
Compliance Audit**

July 2011 through March 2014

February 23, 2015

Report 15-03

FINANCIAL AUDIT DIVISION
Centennial Building – Suite 140
658 Cedar Street – Saint Paul, MN 55155
Telephone: 651-296-4708 • Fax: 651-296-4712
E-mail: legislative.auditor@state.mn.us
Website: <http://www.auditor.leg.state.mn.us>
Through Minnesota Relay: 1-800-627-3529 or 7-1-1

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Conclusion on Internal Controls

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

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



OFFICE OF THE LEGISLATIVE AUDITOR

STATE OF MINNESOTA • James Nobles, Legislative Auditor

February 23, 2015

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Minnesota Pollution Control Agency

This report presents the results of our internal control and compliance audit of the Minnesota Board of Water and Soil Resources' and the Minnesota Pollution Control Agency's expenditures from the Clean Water Fund for the period from July 1, 2011, through March 31, 2014. The objectives of this audit were to determine if the board and the agency had adequate internal controls for its Clean Water Fund expenditures and complied with finance-related legal requirements.

We discussed the results of the audit with the board's and the agency's staff at exit conferences on February 10, 2015. This audit was conducted by Scott Tjomsland, CPA, CISA (Audit Manager) and auditors Joan Haskin, CPA, CISA, Sandy Ludwig, Tracia Polden, Heather Varez, CPA, CFE, and Zach Yzermans, CPA.

We received the full cooperation of the board's and the agency's staff while performing this audit.

Handwritten signature of James R. Nobles in black ink.

James R. Nobles
Legislative Auditor

Handwritten signature of Cecile M. Ferkul in black ink.

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

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Report Summary

Water is one of Minnesota's most important natural resources. To help protect the resource, in 2008, voters approved a constitutional amendment to dedicate one-third of an additional sales tax to the Clean Water Fund.¹ The constitutional amendment requires that money in this fund be used "To protect, enhance, and restore water quality in lakes, rivers, and streams and to protect groundwater from degradation, and . . . to protect drinking water sources." The Legislature appropriates money from the Clean Water Fund for specific activities. The two largest recipients of appropriations from the fund are the Board of Water and Soil Resources and the Pollution Control Agency.

This audit examined expenditures from the Clean Water Fund by the Board of Water and Soil Resources and the Pollution Control Agency, during the period from July 2011 through March 2014. The audit focused on whether the board and the agency had adequate internal controls to ensure that they used money from the Clean Water Fund in compliance with purposes described in the state constitution, the appropriation laws, and in compliance with other finance-related legal requirements.

Conclusion

The Board of Water and Soil Resources and the Pollution Control Agency each had generally adequate internal controls and generally complied with most legal requirements applicable to spending money from Clean Water Fund appropriations. However, both the board and the agency had some internal control weaknesses and instances of noncompliance.

Key Findings

- The Board of Water and Soil Resources could not demonstrate that it limited administrative cost allocations to its Clean Water Fund appropriations to actual costs that were directly related to and necessary for each specific appropriation. ([Finding 1, page 9](#))
- The Board of Water and Soil Resources did not deposit returned grant money from the Clean Water Fund appropriations or certain interagency receipts into the proper appropriation accounts. ([Finding 2, page 14](#))
- The Pollution Control Agency did not comply with state guidelines for allocating costs to its Clean Water Fund appropriations. ([Finding 3, page 16](#))

¹ *Minnesota Constitution*, art. XI, sec. 15, provides for the distribution of additional dedicated sales tax into four funds; 33 percent to the Clean Water Fund; 33 percent to the Outdoor Heritage Fund; 19.75 percent to the Arts and Cultural Heritage Fund; and 14.25 percent to the Parks and Trails Fund.

Background

Water is one of Minnesota’s most important natural resources. To help protect the resource, in 2008, Minnesota voters approved a constitutional amendment to increase state sales tax by three-eighths of 1 percent for a 25-year period; dedicating one-third of the additional sales tax to the Clean Water Fund.² The constitutional amendment (sometimes referred to as the Legacy Amendment) requires that the money in the Clean Water Fund be used “to protect, enhance, and restore water quality in lakes, rivers, and streams and to protect groundwater from degradation, and at least five percent . . . must be spent only to protect drinking water sources.” The Legislature appropriates money from the Clean Water Fund for specific programs and activities.

Table 1 summarizes the Clean Water Fund appropriations to governmental entities in fiscal years 2012, 2013, and 2014.

Table 1
Clean Water Fund Appropriations
Fiscal Years 2012, 2013, and 2014

Governmental Entities	FY 2012	FY 2013	FY 2014
Board of Water and Soil Resources ¹	\$27,534,000	\$31,734,000	\$30,689,000
Pollution Control Agency ¹	24,212,000	23,558,000	28,365,000
Public Facilities Authority	16,710,000	16,710,000	11,000,000
Department of Natural Resources	10,860,000	9,860,000	12,635,000
Department of Agriculture	7,700,000	7,700,000	7,310,000
Department of Health	2,988,000	3,050,000	4,635,000
Metropolitan Council	500,000	500,000	2,037,000
University of Minnesota	0	1,800,000	615,000
Legislature	13,000	0	15,000
Total	\$90,517,000	\$94,912,000	\$97,301,000

¹ See Appendix A for a detailed list of Clean Water Fund appropriations to the Board of Water and Soil Resources and the Pollution Control Agency for fiscal years 2012, 2013, and 2014.

Source: *Laws of Minnesota* 2011, First Special Session, chapter 6, art. 2; *Laws of Minnesota* 2012, chapter 264, art. 2; and *Laws of Minnesota* 2013, chapter 137, art. 2.

This audit examined expenditures from the Clean Water Fund appropriations to the Board of Water and Soil Resources and the Pollution Control Agency, which were the two largest recipients of Clean Water Fund money in fiscal years 2012, 2013, and 2014.

² *Minnesota Constitution*, art. XI, sec. 15, provides for the distribution of the additional dedicated sales tax into four funds, as follows: 33 percent to the Clean Water Fund; 33 percent to the Outdoor Heritage Fund; 19.75 percent to the Arts and Cultural Heritage Fund; and 14.25 percent to the Parks and Trails Fund.

Board of Water and Soil Resources

The Legislature established the Board of Water and Soil Resources in 1987 when it combined the Soil and Water Conservation Board with the Water Resources Board and the Southern Minnesota Rivers Basin Council. As set forth in *Minnesota Statutes* 2014, 103B.101, the board consists of 20 members, including 15 appointed by the Governor; the commissioners of the Departments of Agriculture, Health, Natural Resources, and the Pollution Control Agency; and the director of the University of Minnesota Extension Service. The board employs an executive director to oversee daily operations. The board works in partnership with Minnesota's 89 soil and water conservation districts, 46 watershed districts, 23 metropolitan watershed management organizations, and 80 county water managers, as well as private landowners, to improve and protect Minnesota's water and soil resources. The board employs staff throughout the state housed at nine office locations, including the central and metro field office in St. Paul and field offices in Bemidji, Brainerd, Duluth, Detroit Lakes, Mankato, Marshall, New Ulm, and Rochester.

Pollution Control Agency

The Legislature established the Pollution Control Agency in 1967 to protect the air, waters, and land in Minnesota. The agency's daily operations are directed by a commissioner, while agency policy and direction are set by the Pollution Control Agency Citizens' Board. As set forth in *Minnesota Statutes* 2014, 116.02, the Citizens' Board consists of the commissioner and eight members appointed by the Governor who are not employees of the state or federal government. The agency's mission is to protect and improve the environment and enhance human health. The agency employs staff throughout the state housed at eight office locations, including the central and metro regional office in St. Paul and regional offices in Brainerd, Detroit Lakes, Duluth, Mankato, Marshall, Rochester, and Willmar.

Clean Water Fund Appropriations

The Clean Water Fund appropriations to the Board of Water and Soil Resources and the Pollution Control Agency provided funding for specific purposes. Most of the appropriations to the board were intended for various grant programs that primarily provided money to local government units, and for the purchase of conservation easements.³ Most of the appropriations to the agency were intended for water quality program activities performed by agency staff or hired contractors.

³ A conservation easement is a legal restriction placed on a parcel of land that limits its use. Landowners receive an easement payment in return for establishing conservation practices on the land, but retain full ownership of the land. The easement is recorded on the land title with the county recorder and transfers with the land if the parcel is sold.

Table 2 summarizes the board’s and the agency’s expenditures from selected Clean Water Fund appropriations from July 1, 2011, through March 31, 2014.

Table 2
Board of Water and Soil Resources and the Pollution Control Agency
Expenditures by Type from Selected Appropriations¹
July 1, 2011, through March 31, 2014

<u>Expenditures</u>	<u>Board of Water and Soil Resources</u>	<u>Pollution Control Agency</u>
Grants	\$29,743,953	\$8,083,778
Easements	8,203,621	0
Contracted Services	1,370,271	25,966,906
Payroll	3,973,681	16,273,848
Indirect Costs	0 ²	8,530,032
Other Purchased Services, Supplies, Equipment, and Other Expenses	<u>337,725</u>	<u>4,601,874</u>
Total Expenditures	<u>\$43,629,251</u>	<u>\$63,456,438</u>

¹ See Appendix A for the selected Clean Water Fund appropriations to the Board of Water and Soil Resources and the Pollution Control Agency.

² Instead of using an indirect cost plan, the Board of Water and Soil Resources transferred money from its Clean Water Fund appropriations to an administrative account it created in the Clean Water Fund, and paid administrative costs directly from that account. The board’s process is described in more detail in Finding 1.

Source: State of Minnesota’s accounting system.

Objective, Scope, and Methodology

The objective of our audit of Clean Water Fund expenditures made by the Board of Water and Soil Resources and the Pollution Control Agency, for the period of July 2011 through March 2014, was to answer the following questions:

- Did the Board of Water and Soil Resources and the Pollution Control Agency have adequate internal controls to ensure that they used money from Clean Water Fund appropriations for the intended purposes, accurately paid employees, grantees, and vendors in accordance with management’s authorizations, complied with finance-related legal requirements, and created reliable financial data?
- For the transactions tested, did the Board of Water and Soil Resources and the Pollution Control Agency spend money from Clean Water Fund appropriations in compliance with the constitution; state statues and laws; state, board, and agency policies; and other applicable finance-related legal requirements?

To answer these questions, we performed the following steps:

- We reviewed the appropriation laws to gain an understanding of the intended purpose of and requirements for each selected Clean Water Fund appropriation. In addition, we gained an understanding of the board's and the agency's financial policies and procedures.
- We considered the risk of errors in the accounting records and potential noncompliance with relevant legal requirements. This included a review of the processes used by the board and the agency to ensure they only spent money from Clean Water Fund appropriations on activities that were directly related to and necessary for the specific appropriations.⁴
- We obtained and analyzed the board's and the agency's accounting data to identify unusual trends or significant changes in financial operations. We examined samples of financial transactions and reviewed supporting documentation to test whether the board's and the agency's controls were effective and if the transactions complied with laws, regulations, policies, and contract provisions.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective.

We used various criteria to evaluate internal controls and compliance. We used, as our criteria to evaluate board and agency controls, the guidance contained in the *Internal Control-Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission.⁵ We used state and federal laws, regulations, and contracts, as well as policies and procedures established by the departments of Management and Budget and Administration and the board's and the agency's policies and procedures as evaluation criteria over compliance.

Conclusion

The Board of Water and Soil Resources and the Pollution Control Agency each had generally adequate internal controls and generally complied with most legal

⁴ *Laws of Minnesota* 2011, First Special Session, chapter 6, art. 2, sec. 2, subd. 2 and *Laws of Minnesota* 2013, chapter 137, art. 2, sec. 2, subd. 2, stated "Money appropriated...may not be spent on activities unless they are directly related to and necessary for a specific appropriation."

⁵ The Treadway Commission and its Committee of Sponsoring Organizations were established in 1985 by the major national associations of accountants. One of their primary tasks was to identify the components of internal control that organizations should have in place to prevent inappropriate financial activity. The resulting *Internal Control-Integrated Framework* is the accepted accounting and auditing standard for internal control design and assessment.

requirements applicable to spending money from Clean Water Fund appropriations. However, both the board and the agency had some internal control weaknesses and instances of noncompliance.

The following *Findings and Recommendations* section further explains the exceptions noted above.

Findings and Recommendations

The Board of Water and Soil Resources could not demonstrate that it limited administrative cost allocations to its Clean Water Fund appropriations to actual costs that were directly related to and necessary for each specific appropriation.

Finding 1

The Board of Water and Soil Resources developed a methodology to estimate and allocate administrative costs to Clean Water Fund appropriations that was generally reasonable; however, the board did not validate or accurately execute the methodology. As a result, the board could not show that it had limited administrative cost allocations to Clean Water Fund appropriations to costs that were directly related to and necessary for each specific appropriation.

The laws that appropriated Clean Water Fund money to the board stated that “Money appropriated . . . may not be spent on activities unless they are directly related to and necessary for a specific appropriation.”⁶ In addition, guidance issued by the Department of Management and Budget on the use of money from Legacy funds states that for costs to be allowable, they “. . . should be necessary for the legacy programs they are supporting.”⁷

In developing a methodology to determine the costs of administering its Clean Water Fund grant and easement programs, the board did the following:

- The board identified its total administrative costs,⁸ and how much of those costs were related to the administration of its Clean Water Fund grant appropriations and its Clean Water Fund easement appropriations, based on estimates of percentages of employees’ time spent working on Clean Water Fund activities.
- The board then proportionately allocated the Clean Water Fund’s estimated administrative costs to the specific grant and easement appropriations.

⁶ *Laws of Minnesota* 2011, First Special Session, chapter 6, art. 2, sec. 2, subd. 2 and *Laws of Minnesota* 2013, chapter 137, art. 2, sec. 2, subd. 2.

⁷ *Laws of Minnesota* 2013, chapter 137, art. 2, sec. 2, subd. 2, states, “Money appropriated in this article must be spent in accordance with Minnesota Management and Budget’s Guidance to Agencies on Legacy Fund Expenditure.” The Department of Management and Budget issued that guidance in December 2012.

⁸ The board’s administrative costs included payroll, office rent, computer services, phones, vehicle rent, and travel.

- Finally, the board transferred amounts from the specific Clean Water Fund appropriations into an account it created in the Clean Water Fund from which it paid the administrative costs.

Table 3 shows the amounts transferred each fiscal year.

Table 3
Board of Water and Soil Resources
Clean Water Fund Appropriations for Grants and Easements
Amounts Transferred Out for Allocated Administrative Costs
Fiscal Years 2012, 2013, and 2014

	<u>2012</u>	<u>2013</u>	<u>2014</u>
Clean Water Fund Grant Appropriations	\$19,250,000	\$22,150,000	\$21,855,000
Transfers-out for Administrative Costs	<u>(1,101,313)</u>	<u>(806,038)</u>	<u>(1,930,000)</u>
Grant Appropriations after Transfers-out	<u>\$18,148,687</u>	<u>21,343,962</u>	<u>19,925,000</u>
Clean Water Fund Easement Appropriations	\$ 7,300,000	\$ 8,300,000	\$ 7,800,000
Transfers-out for Administrative Costs	<u>(673,685)</u>	<u>(230,458)</u>	<u>(290,000)</u>
Easement Appropriations after Transfers-out	<u>\$ 6,626,315</u>	<u>\$ 8,069,542</u>	<u>\$ 7,510,000</u>

Source: State of Minnesota's accounting system.

While the methodology was generally reasonable, it had the following deficiencies:

- Estimated Administrative Costs Not Validated. The board did not compare the total estimated administrative costs used in its cost allocation methodology to the actual costs incurred to determine if any adjustments to the cost allocations were necessary. In addition, for about 70 percent of the board's employees with payroll costs allocated to the Clean Water Fund,⁹ the board did not validate whether the estimated percentages of work time related to Clean Water Fund grant or easement activities reasonably approximated the actual time those employees applied.¹⁰ The board used the estimated payroll percentages in its cost allocation methodology to apportion its total estimated administrative costs to the Clean Water Fund grant and easement appropriations.

⁹ The board did have a process for its board conservationists, but those positions represented less than 30 percent of the employees with payroll costs allocated to the Clean Water Fund appropriations.

¹⁰ This issue was previously reported in Office of the Legislative Auditor's Financial Audit Division Report 11-27, *Legacy Funds: Outdoor Heritage, Clean Water, and Parks and Trails*, issued November 30, 2011 (Finding 1).

The Department of Management and Budget's guidance addresses the use of estimated percentages of payroll costs and states:

The amount of staff compensation charged to legacy funds for wages, salary, and benefits should be reflective of their workload on legacy projects. Agencies should have checks in place to ensure that legacy funds – and all other state funds – are charged in a way that accurately reflects actual employee time. This could include staff tracking their actual time spent on legacy programs on an on-going basis, or allocating cost according to staff position descriptions. If an agency does not have a personnel time report system that can handle actual hours, a reasonable percentage of time spent on legacy activities approach could be used, and the percentage used for individual programs should be checked at least quarterly to be sure that it is accurate. If there are discrepancies found, the agencies should complete expenditure corrections and adjust position descriptions accordingly.

Without a periodic validation of the board's administrative cost estimates to the actual costs, and employees' expected activities to how they actually used their time, the board's cost allocation methodology may not accurately associate costs with the specific appropriations to which they were directly related and necessary.

- Formula Errors. The electronic spreadsheets the board used for its 2014 cost allocation methodology had 36 formula errors, resulting in an overstated estimate of the Clean Water Fund's grant and easement administrative costs of about \$50,000.

The board also had the following deficiencies in its allocations of administrative costs to Clean Water Fund grant and easement appropriations:

- Unexplained Adjustments and Transfer Amounts. Board staff did not have documentation to support (and could not explain to us) adjustments they made to the grant and easement programs' administrative cost estimates determined through the cost allocation methodology. Board staff also did not have documentation to support (and could not explain to us) why the amounts they transferred from the specific appropriations into the administrative cost account were different from the estimated administrative costs. The Department of Management and Budget's guidance instructs agencies to document how they allocated administrative costs to the Legacy funds.

Table 4 shows our comparison of the board's administrative cost estimates and amounts transferred each fiscal year.

Table 4
Board of Water and Soil Resources
Clean Water Fund Appropriations for Grants and Easements
Comparison of Administrative Cost Estimates and Actual Transfers
to the Clean Water Fund Administrative Account
Fiscal Years 2012 through 2014

Appropriation Type and Fiscal Year	(a) Per Methodology	(b) Unexplained Adjustments	(a + b) Final Estimates	(c) Actual Transfers	(c – (a + b)) Unexplained Transfer Variances
<u>Grant Appropriations</u>					
Fiscal Year:					
2012	\$1,105,903	\$ 0	\$1,105,903	\$1,101,313	(\$ 4,590)
2013	1,191,566	(438,753)	752,813	806,038	53,225
2014	<u>2,031,732</u>	<u>(400,000)</u>	<u>1,631,732</u>	<u>1,930,000</u>	<u>298,268</u>
Total	<u>\$4,329,201</u>	<u>(\$ 838,753)</u>	<u>\$3,490,448</u>	<u>\$3,837,351</u>	<u>\$346,903</u>
<u>Easement Appropriations</u>					
Fiscal Year:					
2012	\$753,685	0	\$753,685	\$673,685	(\$ 80,000)
2013	754,833	0	754,833	230,458	(524,375)
2014	<u>229,422</u>	<u>0</u>	<u>229,422</u>	<u>290,000</u>	<u>60,578</u>
Total	<u>\$1,737,940</u>	<u>0</u>	<u>\$1,737,940</u>	<u>\$1,194,143</u>	<u>(\$543,797)</u>
Overall Totals	<u>\$6,067,141</u>	<u>(\$838,753)</u>	<u>\$5,228,388</u>	<u>\$5,031,494</u>	<u>(\$196,894)</u>

Source: OLA analysis of the board's cost allocation records and the state accounting system's transfer transactions.

- Easement Appropriations Charged Twice for Same Costs. Included in the board's fiscal year 2012 and 2013 administrative cost estimates for the easement programs (as shown in Table 4) was \$638,000 each year that the board planned to use for grants to local governments (to cover their administrative costs of easement purchases) and reimbursements to landowners (for the costs of implementing conservation practices on the land).¹¹ However, the board actually paid those grants and reimbursements, which totaled about \$267,000, directly from the easement appropriations instead of from the administrative cost account. Essentially, the board charged the easement appropriations twice for the grants and reimbursements – once when it paid them directly from the appropriations and again when it transferred money from the appropriations to the administrative cost account. The Department of Management and Budget's guidance cautions “. . . a cost should not be categorized as a direct expenditure to a project if a cost of the same

¹¹ The board's actual transfers to the administrative account for those costs totaled \$704,000. In fiscal year 2014, the board did not include grants to local governments and reimbursements to landowners in its estimated administrative costs calculation.

purpose and in similar circumstances has been allocated to the award as an indirect expenditure.”

- Money Transferred From Easement Appropriations was Used for Grant-related Administrative Costs. The board did not use all the money transferred from the easement appropriations for easement related expenditures. Instead, as shown in Table 5, the board used a portion of the money transferred from the easement appropriations for grant-related administrative costs.¹² The table shows the amounts transferred into the Clean Water Fund administrative cost account from Clean Water Fund grant and easement appropriations for fiscal years 2012 and 2013, and the expenditures from the administrative cost account for costs related to the grant and easement programs.¹³ (The grant deficit is bigger than the easement excess because the account had other money available at the beginning of fiscal year 2012.)

Table 5
Board of Water and Soil Resources
Clean Water Fund Administrative Cost Account
Fiscal Years 2012 and 2013 (combined)

	<u>Grants</u>	<u>Easements</u>
Actual Transfers In	\$1,907,351	\$904,143
Administrative Cost Expenditures	<u>2,607,811</u>	<u>252,756</u>
Excess Transfers/(Expenditures)	<u>\$ (700,460)</u>	<u>\$651,387</u>

Source: OLA analysis of the board's cost allocation records and the state's accounting system.

The board received a Clean Water Fund appropriation each fiscal year for purposes other than grants and easements, but had inconsistencies in how it used money from these appropriations for administrative costs, including the following:

- In fiscal year 2012, the board allocated to this appropriation about \$49,190 of the administrative costs it estimated for its Clean Water Fund grant programs. It did not allocate any administrative costs to the appropriation in fiscal years 2013 or 2014 as part of that cost allocation plan.
- In fiscal years 2012 and 2014, the board paid \$32,110 and \$122,039, respectively, in administrative costs for payroll directly from the

¹² We think that the negative \$438,753 unexplained adjustment to the fiscal year 2013 administrative cost estimate for the grant appropriations in Table 4 may have been made by board staff to use the unspent balance in the administrative cost account at the end of fiscal year 2012.

¹³ The board did not distinguish between grant and easement costs when it made payments from the Clean Water Fund administrative cost account. We used the board's cost allocation methodology to classify the expenditures as either grant related or easement related.

appropriations.¹⁴ However, the board did not allocate any costs for office rent, computer services, phones, vehicle rent, or travel to the appropriation.

As a result of all of these problems, the board could not demonstrate, and we could not validate, that money from each specific Clean Water Fund appropriation was only used for activities that were directly related to and necessary for that appropriation.

Recommendations

- *The Board of Water and Soil Resources should improve its methodology to calculate and its process to allocate administrative costs to Clean Water Fund appropriations by:*
 - *fixing formula errors;*
 - *periodically verifying the estimated administrative costs to the actual administrative costs, and employees' expected activities to their actual activities;*
 - *documenting all adjustments to cost allocations and transfer amounts; and*
 - *establishing controls to ensure that it uses money transferred into the administrative cost account for the intended costs.*
- *The Board of Water and Soil Resources should restore to the easement appropriations from the Clean Water Fund the money it used for grant-related administrative costs.*

Finding 2

The Board of Water and Soil Resources did not deposit returned grant money from the Clean Water Fund appropriations or certain interagency receipts into the proper appropriation accounts.

In the state's accounting system, agencies establish separate accounts for each appropriation from the Legislature, including those from the Clean Water Fund. Those accounts contain controls limiting the availability of each appropriation to the period of time specified by the Legislature. Using separate accounts also helps agencies ensure that they use each appropriation for its intended purpose. We identified the following instances where the board did not deposit receipts into the proper account, which made those appropriation controls ineffective.

¹⁴ In fiscal year 2013, the board did not pay any administrative costs directly from the appropriation.

- The board did not deposit about \$396,000 of returned grant money into the Clean Water Fund accounts from which it paid the grants. Instead, the board deposited that money into a Miscellaneous Special Revenue Fund account. The board paid the grants from several fiscal years 2010 and 2011 Clean Water Fund appropriations, which were available to the board until June 30, 2010, and June 30, 2012, respectively.¹⁵ Any portion of the appropriations not used by those dates should revert to the Clean Water Fund for future appropriations by the Legislature. In contrast, money in the Miscellaneous Special Revenue Fund account is available until it is spent. Since the board collected all of the returned grant money after the last available date for the respective Clean Water Fund appropriations, the money should have reverted to the Clean Water Fund. Depositing the money into the Miscellaneous Special Revenue Fund account allowed the board to retain the money beyond the dates made available by the Legislature, and increased the risk of the board using the money for purposes other than those specified by the Legislature for each appropriation.
- The board did not deposit about \$85,000 in interagency receipts from the Pollution Control Agency into the same account from which it paid the corresponding expenditures. The board and the agency executed an interagency agreement for a water quality project managed by the board. The agreement required the agency to provide \$341,605 from a federal award for the project, and the board to provide \$130,000 from a Clean Water Fund appropriation. The project was still in progress as of September 30, 2014, but through that date the board had spent about \$382,000 (\$167,000 of the agency's share of project costs paid from a Miscellaneous Special Revenue Fund account, and \$85,000 of the agency's share plus the board's \$130,000 share paid from a Clean Water Fund account). However, the board deposited all the receipts from the agency into the Miscellaneous Special Revenue Fund account, instead of splitting those receipts between the accounts from which it paid the agency's share of project costs.

¹⁵ *Laws of Minnesota* 2009, chapter 172, art. 2, sec. 1 stated that Clean Water Fund appropriations for fiscal years 2010 and 2011 "...are available for the fiscal year ending June 30, 2010, or June 30, 2011, respectively." *Laws of Minnesota* 2010, chapter 361, art. 2, sec. 6(e) stated, "The appropriations in fiscal year 2011 to the Board of Water and Soil Resources in Laws 2009, chapter 172, article 2, section 6, are available until June 30, 2012...."

Recommendations

- *The Board of Water and Soil Resources should revert the \$396,000 in returned grant money to the Clean Water Fund, and should reallocate \$85,000 in project expenditures from the Clean Water Fund account to the Miscellaneous Special Revenue Fund account.*
- *The Board of Water and Soil Resources should deposit returned grant money into the accounts from which it paid the grants, and should deposit interagency receipts into the same account from which it paid corresponding expenditures.*

Finding 3**The Pollution Control Agency did not comply with state guidelines for allocating costs to its Clean Water Fund appropriations.**

The Pollution Control Agency received several Clean Water Fund appropriations intended for specific activities. The appropriation laws stated that “Money appropriated . . . may not be spent on activities unless they are directly related to and necessary for a specific appropriation.”¹⁶ The agency paid program costs related to a specific appropriation directly from that appropriation, and allocated a share of its administrative costs to each appropriation using an indirect cost plan. We identified instances of noncompliance with allocations of indirect costs and program payroll costs to Clean Water Fund appropriations.

Lower Indirect Cost Rate for Clean Water Fund Appropriations. The agency used an indirect cost plan to allocate administrative costs to its Clean Water Fund appropriations, but used a lower indirect cost rate than it used to allocate costs to appropriations from other funds. For example, in fiscal year 2014, the agency only used about 10 percent of its Clean Water Fund appropriations for administrative costs, but used about 20 percent of its appropriations from other state funds for those costs. The Department of Management and Budget’s Guidance to Agencies on Legacy Fund Expenditure¹⁷ states, “The ‘direct and necessary’ requirement does not prohibit the use of indirect cost billing for necessary administrative costs” It also states, “Under law and state policy, all state funds, including the legacy funds, should pay their portion of administrative costs, and not be subsidized by the general fund or other dedicated funding sources.”

¹⁶ *Laws of Minnesota* 2011, First Special Session, chapter 6, art. 2, sec. 2, subd. 2 and *Laws of Minnesota* 2013, chapter 137, art. 2, sec. 2, subd. 2.

¹⁷ *Laws of Minnesota* 2013, chapter 137, art. 2, sec. 2, subd. 2 states “Money appropriated in this article must be spent in accordance with Minnesota Management and Budget’s Guidance to Agencies on Legacy Fund Expenditure.”

Estimates for Payroll Costs Not Validated. Minnesota Management and Budget's guidance established requirements for charging payroll costs to appropriations, as follows:

The amount of staff compensation charged to legacy funds for wages, salary, and benefits should be reflective of their workload on legacy projects. Agencies should have checks in place to ensure that legacy funds – and all other state funds – are charged in a way that accurately reflects actual employee time. This could include staff tracking their actual time spent on legacy programs on an on-going basis, or allocating cost according to staff position descriptions. If an agency does not have a personnel time report system that can handle actual hours, a reasonable percentage of time spent on legacy activities approach could be used, and the percentage used for individual programs should be checked at least quarterly to be sure that it is accurate. If there are discrepancies found, the agencies should complete expenditure corrections and adjust position descriptions accordingly.

Before the start of each fiscal year, the agency assigned percentages of payroll costs for each employee to specific appropriations based on estimated work activities to be performed during the year. The agency was also developing and implementing a time keeping system for employees to track actual time spent working on various activities. By March 2014, some agency employees were effectively using the time keeping system. For those employees, the agency charged payroll costs for hours worked to appropriations based on actual work activities performed instead of estimated work activities.

For employees that did not use the time keeping system, the agency did not have a process to validate at least quarterly that the assigned percentage of payroll costs paid from Clean Water Fund appropriations was accurate based on actual work activities performed.¹⁸ We identified one employee with 50 percent of payroll costs paid from a Clean Water Fund appropriation in fiscal year 2013, but just 10 percent paid from that appropriation in fiscal year 2014. Agency staff told us that they reduced the percentage for fiscal year 2014 after determining that the employee had only worked about 10 to 20 percent on activities related to that appropriation in fiscal year 2013. However, the agency did not record an expenditure correction to reallocate fiscal year 2013 payroll costs. A correction to reduce the percentage charged to the Clean Water Fund appropriation to 20 percent would have reallocated about \$22,000 in payroll costs to an appropriation in another fund.

¹⁸ This issue was reported in the Office of the Legislative Auditor's Financial Audit Division, report 11-27, *Legacy Funds: Outdoor Heritage, Clean Water, and Parks and Trails*, issued November 30, 2011 (Finding 1).

For employees that used the time keeping system, the agency charged payroll costs for paid time off to appropriations based on estimated work activities instead of actual work performed. The agency did not have a process to reallocate payroll costs for paid time off in the same proportion as payroll costs for actual hours worked.¹⁹ Minnesota Management and Budget’s guidance states “Employee benefits in the form of regular compensation paid to employees during periods of authorized absences from the job, . . . are allowed if . . . the cost is equitably allocated to all related activities.” We identified one employee that charged 77 percent of the payroll costs for hours worked to a Clean Water Fund appropriation but had all paid time off charged to that appropriation. The agency should have reallocated about \$3,000 in payroll costs for the paid time off to an appropriation in another fund. We also identified an employee that charged 82.5 percent of the payroll costs for hours worked to a Clean Water Fund appropriation but had 75 percent of the payroll costs for paid time off charged to that appropriation. The agency should have reallocated about \$4,200 in payroll costs for paid time off to the Clean Water Fund appropriation from appropriations in other funds.

Recommendations

- *The Pollution Control Agency should allocate administrative costs to Clean Water Fund appropriations using the same indirect cost rate used for allocations to appropriations from other state funds.*
- *The Pollution Control Agency should improve its procedures to ensure it equitably allocates payroll costs to Clean Water Fund appropriations.*

Finding 4

The Board of Water and Soil Resources and the Pollution Control Agency paid \$3,500 and about \$25,000, respectively, from Clean Water Fund appropriations for activities that were not directly related to and necessary for the appropriations.

The Clean Water Fund appropriation laws stated that, “Money appropriated . . . may not be spent on activities unless they are directly related to and necessary for a specific appropriation.”²⁰ We identified the following expenditures from Clean Water Fund appropriations that were not for activities related to those appropriations:

- The Board of Water and Soil Resources paid a \$3,500 invoice from a Clean Water Fund appropriation for easements that was for activities

¹⁹ Ibid., p. 17.

²⁰ *Laws of Minnesota* 2011, First Special Session, chapter 6, art. 2, sec. 2, subd. 2 and *Laws of Minnesota* 2013, chapter 137, art. 2, sec. 2, subd. 2.

related to an appropriation in a different fund. Notes written on the invoice indicated that the board intended to pay it from the correct appropriation, but inadvertently selected a Clean Water Fund appropriation purchase order to pay it from.

- The Pollution Control Agency paid about \$25,000 from a Clean Water Fund appropriation for expense reimbursements to 49 employees that worked on activities related to other appropriations.
 - Approximately \$23,000 of these reimbursements were to 43 employees whose payroll costs were paid from other funds.
 - Approximately \$2,000 of these reimbursements were to 6 employees whose payroll costs were paid from other Clean Water Fund appropriations.

Recommendations

- *The Board of Water and Soil Resources and the Pollution Control Agency should process expenditure corrections to reallocate the expenditures to the proper appropriation.*
- *The Board of Water and Soil Resources and the Pollution Control Agency should strengthen procedures to ensure that they pay expenditures from the proper appropriations.*

The Pollution Control Agency and the Board of Water and Soil Resources did not accurately calculate certain nonroutine payroll payments to employees.

Finding 5

Inaccurate Military Salary Differential Payments. The Pollution Control Agency underpaid one employee by about \$8,400 for military salary differential pay.²¹ *Minnesota Statutes* 2014, 43A.183, subd. 1, states, “Each agency head shall pay to each eligible member an amount equal to the person’s salary differential for each month or portion of month that the person is ordered to serve in active service.” *Minnesota Statutes* 2014, 43A.183, subd. 2(b), defines salary differential:

“Salary differential” means the difference between: (1) the person’s monthly total gross earnings as an active state employee, excluding any overtime pay received but including all other earnings, averaged over the last three full months of the person’s active state employment prior to reporting to active service, and including any additional salary or earnings adjustments that the person would have received at any time during the

²¹ Approximately \$7,200 should be allocated to the Clean Water Fund, with the rest allocated to a different fund.

person's authorized leave from state employment had the person been serving as an active state employee during that time; and (2) the person's monthly base pay in active service.

The Department of Management and Budget developed a worksheet for agencies to calculate an employee's average monthly pay for the last three full months worked before being called to active service. The Pollution Control Agency used that worksheet, but instead of using the employee's earnings for each paid day during those months in the calculation (there were between 21 and 23 paid days each month), it used the earnings for two pay periods (20 days) in each month. In addition, the agency did not recognize that the employee had received a pay rate increase for those last three full months worked, and used the old pay rate in the calculation.

Inaccurate Pay Rate Adjustment Payments. The Board of Water and Soil Resources and the Pollution Control Agency miscalculated payments for pay rate adjustments to several employees. All of those payments were either fully or partially paid from Clean Water Fund appropriations. Department of Management and Budget Policy PAY0025 states, "When an employee receives a change in pay rate, . . . the change will have an effective date. . . . If the effective date is in a past pay period, a pay rate adjustment is necessary." The board and the agency miscalculated three and eleven payments, respectively, resulting in seven overpayments ranging from \$21 to \$325 and seven underpayments ranging from \$39 to \$506.

Recommendations

- *The Board of Water and Soil Resources and the Pollution Control Agency should make additional payments to employees to correct the underpayments and should collect overpayments from employees.*
- *The Board of Water and Soil Resources and the Pollution Control agency should strengthen their procedures to ensure the accuracy of nonroutine payroll payments to employees.*

Finding 6

The Board of Water and Soil Resources and the Pollution Control Agency did not comply with state requirements to ensure the integrity of employee time reporting and accuracy of payroll expenditures.

The Board of Water and Soil Resources and the Pollution Control Agency did not review key payroll reports designed to ensure the integrity of employee time reporting and accuracy of payroll expenditures. The board and the agency also weakened the integrity of employee time reporting by providing some employees the ability to approve their own hours worked and leave taken. Both board and

agency employees enter hours worked and leave hours into the state's self service time entry system. Once supervisors review and approve employee time, the hours are uploaded into the state's payroll system. Between July 2011 and March 2014, the board and the agency spent about \$19.8 million and \$199.9 million, respectively, on employee payroll costs from all funding sources.

Department of Management and Budget Policy PAY0017 has several requirements to ensure the integrity of payroll hours reported through the self service time entry system, including the following:

The best control over the integrity of employees' payroll information is achieved when employees prepare their own timesheets and supervisors, who have direct knowledge of employees' work, review and approve timesheets.

Agencies are responsible for assigning employee job records to department IDs to properly reflect employee/supervisor relationships.

Employees are responsible for completing and modifying their timesheets.

Supervisors/managers are responsible for reviewing and approving employee timesheets.

Use of backup approvers and payroll staff to modify or approve employee timesheets is permitted, but should be strictly limited. When backup approvers and payroll staff modify or approve timesheets, they should document the reason for the modification or approval

Employees should not approve their own timesheets.

Payroll staff should review the . . . Self Service Time Entry Audit Report Complete a comprehensive review of the report each pay period This report provides a list of employees whose time entry information was entered and approved in Self Service, but the employee did not personally complete their time entry, and/or the approval was not entered by the primary approver.

The Board of Water and Soil Resources and the Pollution Control Agency assigned five and ten employees, respectively, as backup approvers for their own timesheets. We reviewed all of those employees' timesheets and found one instance where a Pollution Control Agency employee approved her own timesheet.

Department of Management and Budget Policy PAY0028 includes several requirements to ensure the accuracy of payroll transactions, including the following:

Agencies must verify the accuracy of payroll and human resources transactions Various system edits and reports . . . are used to ensure the accuracy of payroll and human resources transactions.

Agency payroll and human resources designees must review the Payroll Register to verify that: Time and amounts were paid at the correct rate, and Any [*sic*] necessary adjustments were processed.

An agency accounting or program manager designee must review the Payroll Posting Audit Trail to verify that payroll expenditures were posted to the correct account.

Agencies should document the review of these reports so that the auditors can verify that the review is being accomplished.

The Board of Water and Soil Resources did not review the Payroll Register since November 2012, and the Pollution Control Agency did not document its review of the Payroll Register except when it included certain error codes. Neither the Board of Water and Soil Resources nor the Pollution Control Agency documented any review of the Payroll Posting Audit Trail, although the board claimed it reviewed the report each pay period. Not reviewing those reports increases the risk that inaccurate payroll transactions could occur and not be detected and corrected.

Recommendations

- *The Board of Water and Soil Resources and the Pollution Control Agency should review payroll reports in compliance with state policy.*
- *The Board of Water and Soil Resources and the Pollution Control Agency should not provide employees the ability to approve their own timesheets.*

Finding 7

The Board of Water and Soil Resources did not always document its justification and authorization for hiring new employees at salaries higher than the minimum rate for a position.

The board did not document its justification for hiring six employees at salaries higher than the minimum rate for a position.

Minnesota Rules 2009, 3900.2100, subp. 2, established guidelines for setting employee salaries for new hires:

Salary upon entry into civil service should usually be at the minimum rate for the classification. An appointing authority may make an appointment at the second or third step of a range An appointing authority must receive prior authorization from the commissioner [of the Department of Management and Budget] to make an appointment at or beyond the fourth step of the salary range Appointments above the minimum rate must be based upon the exceptional qualifications of the applicant or the unavailability of applicants at the minimum rate.

In October 2010, the Department of Management and Budget delegated the authority to set salaries for new employees hired by the board to the board's administrative and technical services director. The delegation stated, "This delegation was granted based on the written procedures/guidelines you currently have in place and the knowledge and experience you have gained" Those board guidelines stated, "All relevant information for the candidate regarding compensation decisions should be included on the approved form" That form included various elements to be considered for salary decisions, such as education, experience, and specialized skills, and required the signature of the administrative and technical services director.

We identified 18 employees hired by the board between July 2011 and March 2014 with initial salaries set above the third step of the positions' salary range. The board allocated at least a portion of the salaries for nine of them to Clean Water Fund appropriations, and we requested documentation of the board's justification for the higher salary for those nine. However, the board did not have any documented justification for six of those employees. For the other three, the higher salaries were reasonable based on the board's documented justification, but the authorization signature of the administrative and technical services director was missing for one of them.

Recommendation

- *The Board of Water and Soil Resources should document its justification and authorization for hiring new employees at salaries higher than the minimum rate for a position.*
-

Finding 8

The Board of Water and Soil Resources did not require easement implementation program grantees to document their easement implementation costs.²²

The board awarded easement implementation program grants equal to \$2,000 per easement to local soil and water conservation districts. During the scope of the audit, the board disbursed \$434,000 to 28 districts from its Clean Water Fund appropriations for easements. The board determined that \$2,000 per easement was a reasonable amount to offset the costs incurred by districts to help the board acquire easements, and did not require the districts to document their actual costs. The Clean Water Fund appropriation laws stated that, “Money appropriated . . . may not be spent on activities unless they are directly related to and necessary for a specific appropriation.”²³ Not requiring districts to document their easement implementation costs increased the risk that Clean Water Fund appropriations for easements were used for unallowable activities.

The board questioned whether the cost of obtaining and reviewing evidence of grantees’ use of these small grants outweighs the benefit provided. The board may be able to use alternative procedures to obtain sufficient assurance about the appropriate use of the grants. For example, it could have grantees certify they used the money appropriately and periodically review support documentation for a sample of grants.

Recommendation

- *The Board of Water and Soil Resources should develop procedures to ensure easement implementation program grantees use grants for easement implementation costs.*

Finding 9

The Pollution Control Agency did not document its justification for advances of grant money from a Clean Water Fund appropriation to four Minnesota cities.

The Pollution Control Agency advanced 80 percent of the grants to four Minnesota cities from a Clean Water Fund appropriation without documenting the

²² We reported this same issue for easement implementation program grants paid from proceeds from the sale of general obligation bonds in Office of the Legislative Auditor’s Financial Audit Division, Report 14-06, *General Obligation Bond Expenditures*, issued March 6, 2014. In its response to that report, the board indicated that it would start requiring additional documentation from the grantees by July 2014. However, as of August 2014, the board had not yet implemented those changes.

²³ *Laws of Minnesota* 2011, First Special Session, chapter 6, art. 2, sec. 2, subd. 2 and *Laws of Minnesota* 2013, chapter 137, art. 2, sec. 2, subd. 2.

reason an advance payment was necessary.²⁴ Those advance payments totaled \$241,593, ranging from \$20,800 to \$80,000. Department of Administration Office of Grants Management Policy 08-08 addresses grant payments as follows:

Reimbursement is the preferred method for making grant payments . . . Although they are not preferred, advance payments on grants may be allowed in certain situations In order to make advance payments, agencies must prepare a written justification or include a justification in the grant agreement that details the specific need to utilize advance payments.

The grant agreement with each city included a clause requiring the 80 percent advance payments, with the final 20 percent disbursed after grantees completed the projects and submitted final reports. However, those clauses did not address the need for advance payments, and the agency did not document any justification for the advance payments in its grant files.

Recommendation

- *The Pollution Control Agency should strengthen its procedures to ensure it documents its justification for advances of grant money in compliance with state policy.*

²⁴ *Laws of Minnesota* 2009, chapter 172, art. 2, sec. 4(g), appropriated money from the Clean Water Fund “. . . to provide grants to local units of government for up to 50 percent of the costs to implement best management practices to treat or clean up contaminated sediments in storm water ponds and other waters”

Appendix A: Clean Water Fund Appropriations

The following sections describe the Clean Water Fund appropriations provided to the Board of Water and Soil Resources and the Pollution Control Agency for fiscal years 2012, 2013, and 2014.

Board of Water and Soil Resources

Purpose	FY 2012	FY 2013	FY 2014	Appropriation
Pollution reduction and restoration grants	\$13,750,000	\$15,350,000	\$14,705,000	<i>Laws of Minnesota 2011, First Special Session, chapter 6, art. 2, sec. 7(a), as amended by Laws of Minnesota 2012, chapter 264, art. 2, sec.3; and Laws of Minnesota 2013, chapter 137, art. 2, sec. 7(a) and (b).</i>
Conservation easements	7,300,000	8,300,000	7,800,000	<i>Laws of Minnesota 2011, First Special Session, chapter 6, art. 2, sec. 7(e) and (f), as amended by Laws of Minnesota 2012, chapter 264, art. 2, sec.3; and Laws of Minnesota 2013, chapter 137, art. 2, sec. 7(f) and (g).</i>
Targeted local resource protection and enhancement grants	3,000,000	3,600,000	3,500,000	<i>Laws of Minnesota 2011, First Special Session, chapter 6, art. 2, sec. 7(b), as amended by Laws of Minnesota 2012, chapter 264, art. 2, sec.3; and Laws of Minnesota 2013, chapter 137, art. 2, sec. 7(c).</i>
Community partners grants	1,500,000	1,500,000	1,500,000	<i>Laws of Minnesota 2011, First Special Session, chapter 6, art. 2, sec. 7(g); and Laws of Minnesota 2013, chapter 137, art. 2, sec. 7(h).</i>
Technical assistance and grants for the conservation drainage program	1,000,000	1,700,000	1,700,000	<i>Laws of Minnesota 2011, First Special Session, chapter 6, art. 2, sec. 7(d), as amended by Laws of Minnesota 2012, chapter 264, art. 2, sec.3; and Laws of Minnesota 2013, chapter 137, art. 2, sec. 7(e).</i>
State oversight and accountability	900,000	1,200,000	950,000	<i>Laws of Minnesota 2011, First Special Session, chapter 6, art. 2, sec. 7(c), as amended by Laws of Minnesota 2012, chapter 264, art. 2, sec.3; and Laws of Minnesota 2013, chapter 137, art. 2, sec. 7(d).</i>
Assistance and grants to transition local water management plans to a watershed approach ¹	0	0	450,000	<i>Laws of Minnesota 2013, chapter 137, art. 2, sec. 7(j).</i>
Restoration evaluations ¹	84,000	84,000	84,000	<i>Laws of Minnesota 2011, First Special Session, chapter 6, art. 2, sec. 7(h); and Laws of Minnesota 2013, chapter 137, art. 2, sec. 7(i).</i>
Total	<u>\$27,534,000</u>	<u>\$31,734,000</u>	<u>\$30,689,000</u>	

¹ We did not review expenditures from these appropriations in this audit.

Source: *Laws of Minnesota 2011, First Special Session, chapter 6, art. 2; Laws of Minnesota 2012, chapter 264, art. 2; and Laws of Minnesota 2013, chapter 137, art. 2.*

Pollution Control Agency

<u>Purpose</u>	<u>FY 2012</u>	<u>FY 2013</u>	<u>FY 2014</u>	<u>Appropriation</u>
Total maximum daily load studies and implementation plans	\$9,400,000	\$9,400,000	\$9,400,000	<i>Laws of Minnesota 2011, First Special Session, chapter 6, art. 2, sec. 5(b); and Laws of Minnesota 2013, chapter 137, art. 2, sec. 5(b).</i>
Statewide assessments of surface water quality and trends	7,500,000	7,500,000	7,600,000	<i>Laws of Minnesota 2011, First Special Session, chapter 6, art. 2, sec. 5(a); and Laws of Minnesota 2013, chapter 137, art. 2, sec. 5(a).</i>
Total maximum daily load research and database development	1,150,000	1,150,000	1,150,000	<i>Laws of Minnesota 2011, First Special Session, chapter 6, art. 2, sec. 5(g); and Laws of Minnesota 2013, chapter 137, art. 2, sec. 5(g).</i>
Groundwater assessments	1,125,000	1,125,000	1,125,000	<i>Laws of Minnesota 2011, First Special Session, chapter 6, art. 2, sec. 5(c); and Laws of Minnesota 2013, chapter 137, art. 2, sec. 5(c).</i>
Clean water partnership program grants	1,000,000	1,000,000	1,000,000	<i>Laws of Minnesota 2011, First Special Session, chapter 6, art. 2, sec. 5(e); and Laws of Minnesota 2013, chapter 137, art. 2, sec. 5(e).</i>
Wild rice standards study	1,000,000	500,000	0	<i>Laws of Minnesota 2011, First Special Session, chapter 6, art. 2, sec. 5(j).</i>
Enhancing the county-level delivery system for subsurface sewage treatment systems	862,000	708,000	3,250,000	<i>Laws of Minnesota 2011, First Special Session, chapter 6, art. 2, sec. 5(k); and Laws of Minnesota 2013, chapter 137, art. 2, sec. 5(j).</i>
National pollutant discharge elimination system wastewater and storm water total maximum daily load implementation efforts	800,000	800,000	900,000	<i>Laws of Minnesota 2011, First Special Session, chapter 6, art. 2, sec. 5(h); and Laws of Minnesota 2013, chapter 137, art. 2, sec. 5(i).</i>
Water quality improvements in the lower St. Louis River and Duluth harbor	750,000	750,000	750,000	<i>Laws of Minnesota 2011, First Special Session, chapter 6, art. 2, sec. 5(d); and Laws of Minnesota 2013, chapter 137, art. 2, sec. 5(d).</i>
Storm water research and guidance ¹	400,000	400,000	275,000	<i>Laws of Minnesota 2011, First Special Session, chapter 6, art. 2, sec. 5(f); and Laws of Minnesota 2013, chapter 137, art. 2, sec. 5(f).</i>
Characterize groundwater flow and aquifer properties in the I-94 corridor	225,000	225,000	0	<i>Laws of Minnesota 2011, First Special Session, chapter 6, art. 2, sec. 5(i).</i>
Competitive grant program for sewer projects ¹	0	0	1,500,000	<i>Laws of Minnesota 2013, chapter 137, art. 2, sec. 5(k).</i>
Initiate development of a multiagency watershed database reporting portal ¹	0	0	1,000,000	<i>Laws of Minnesota 2013, chapter 137, art. 2, sec. 5(h).</i>
Wastewater treatment system designs and practices ¹	0	0	375,000	<i>Laws of Minnesota 2013, chapter 137, art. 2, sec. 5(l).</i>
Support for the Clean Water Council ¹	0	0	40,000	<i>Laws of Minnesota 2013, chapter 137, art. 2, sec. 5(m).</i>
Total	\$24,212,000	\$23,558,000	\$28,365,000	

¹ We did not review expenditures from these appropriations in this audit.

Source: *Laws of Minnesota 2011, First Special Session, chapter 6, art. 2 and Laws of Minnesota 2013, chapter 137, art. 2.*



February 19, 2015

James R. Nobles, Legislative Auditor
Office of the Legislative Auditor
140 Centennial Office Building
658 Cedar Street
Saint Paul, Minnesota 55155-4708

Dear Mr. Nobles:

Thank you for the opportunity to respond to the findings and recommendations included in the internal controls and compliance audit on Clean Water Fund Expenditures conducted by your office. Our response addresses findings 1, 2, and 4 through 8, which relate to the Minnesota Board of Water and Soil Resources.

Finding 1. The Board of Water and Soil Resources could not demonstrate that it limited administrative cost allocations to its Clean Water Fund appropriations to actual costs that were directly related to and necessary for each specific appropriation.

Recommendations

- *The Board of Water and Soil Resources should improve its methodology to calculate and its process to allocate administrative costs to Clean Water Fund appropriations by:

 - *fixing formula errors;*
 - *periodically verifying the estimated administrative costs to the actual administrative costs, and employees’ expected activities to their actual activities;*
 - *documenting all adjustments to cost allocations and transfer amounts; and*
 - *establishing controls to ensure that it uses money transferred into the administrative cost account for the intended costs.**
- *The Board of Water and Soil Resources should restore to the easement appropriations from the Clean Water Fund the money it used for grant-related administrative costs.*

Response

We agree with the recommendations, and have already improved our internal controls to ensure that money allocated for administrative costs is used for that purpose alone. We no longer transfer funds to the administrative cost account as they are received, but annually, as they are included in a given fiscal year’s spending plan. A manager must now agree to the amount specified in the spending plan,

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which is established by program staff, and another manager must verify that the amount specified was transferred. In addition, we are performing a risk assessment of our internal processes for ensuring accountability of our funding sources.

We have fixed the formula errors noted in the spreadsheets used to calculate a fiscal year's cost allocations, effective fiscal year 2015. We have also corrected the transfer error in fiscal years 2012 and 2013 noted in the finding. Reversals were taken to restore \$651,387 from the administrative cost account to the easement appropriations.

We are committed to addressing the auditor's recommendation to periodically verify estimated administrative costs to actual administrative costs, and employee's expected activities to their actual activities. As the report notes, we already have a process to validate the work time of our field staff, and we have made considerable efforts to implement an agency-wide system. Because tracking and verifying actual costs is both a challenge and a necessity for every state agency, we believe a standard solution or tool that could be shared across the enterprise would facilitate meeting this goal.

Persons Responsible: Bill Eisele, Administrative and Technology Services Director; Doug Thomas, Assistant Director, Regional Operations.

Estimated Implementation Date: July 2015.

Finding 2. The Board of Water and Soil Resources did not deposit returned grant money from the Clean Water Fund appropriations or certain interagency receipts into the proper appropriation accounts.

Recommendations

- *The Board of Water and Soil Resources should revert the \$396,000 in returned grant money to the Clean Water Fund, and should reallocate \$85,000 in project expenditures from the Clean Water Fund account to the Miscellaneous Special Revenue Account.*
- *The Board of Water and Soil Resources should deposit returned grant money into the accounts from which it paid the grants, and should deposit interagency receipts into the same account from which it paid corresponding expenditures.*

Response

We agree with the recommendations, and have made the corrections specified.

It had been our practice to deposit returned funds in the Miscellaneous Special Revenue Account. Effective fiscal year 2015, returned funds are being returned to their account of origin and, if applicable, cancelled. We have developed two additional tools to improve our tracking of returned grant funds. We now use a checklist specifying the restrictions tied to the use of Clean Water funds to

code disbursements into SWIFT. We added a field for the expiration date of the appropriation to the Grants Encumbrance authorization form. When the funding for a grant comes from two separate sources, as in the second case described in the report, we will explore the option of creating separate accounts for each source of funding.

Persons Responsible: Dave Weirens, Assistant Director, Programs and Policy; Bill Eisele, Administrative and Technology Services Director.

Estimated Implementation Date: Completed.

Finding 4. The Board of Water and Soil Resources paid \$3,500 from Clean Water Fund appropriations for activities that were not directly related to and necessary for the appropriations.

Recommendations

- *The Board of Water and Soil Resources should process expenditure corrections to reallocate the expenditures to the proper appropriation.*
- *The Board of Water and Soil Resources should strengthen procedures to ensure that it pays expenditures from the proper appropriations.*

Response

We agree with the first recommendation, and have made the correction specified.

Although we agree with the intent of the second recommendation, we believe that no changes to our existing procedure are necessary. Under the existing procedure, an accounting technician enters the accounting strings, and a manager reviews the financial report to ensure that accounting strings are entered correctly. The error noted in the report was the result of a coding mistake that was not caught in a subsequent review.

Person Responsible: Bill Eisele, Administrative and Technology Services Director.

Estimated Implementation Date: Completed.

Finding 5. The Board of Water and Soil Resources did not accurately calculate certain nonroutine payroll payments to employees.

Recommendations

- *The Board of Water and Soil Resources should make additional payments to employees to correct the underpayments and should collect overpayments from employees.*
- *The Board of Water and Soil Resources should strengthen its procedures to ensure the accuracy of nonroutine payroll payments to employees.*

Response

We agree with the recommendations. We will make the corrections specified.

To ensure the accuracy of payroll payments to employees, nonroutine adjustments will be referred to a more senior accounting staff person than previously.

Person Responsible: Bill Eisele, Administrative and Technology Services Director.

Estimated Implementation Date: March 2015.

Finding 6. The Board of Water and Soil Resources did not comply with state requirements to ensure the integrity of employee time reporting and accuracy of payroll expenditures.

Recommendations

- *The Board of Water and Soil Resources should review payroll reports in compliance with state policy.*
- *The Board of Water and Soil Resources should not provide employees the ability to approve their own timesheets.*

Response

We have removed the permissions that could have allowed backup approvers to approve their own timesheets. (We note that the auditor did not find an instance of a BWSR employee approving his or her own timesheet.) To ensure the accuracy of payroll transactions, we will periodically review the Payroll Register and document it, and we will document our review of the Payroll Posting Audit Trail.

Person Responsible: Bill Eisele, Administrative and Technology Services Director.

Estimated Implementation Date: February 2015.

Finding 7. The Board of Water and Soil Resources did not always document its justification and authorization for hiring new employees at salaries higher than the minimum rate for a position.

Recommendation

- *The Board of Water and Soil Resources should document its justification and authorization for hiring new employees at salaries higher than the minimum rate for a position.*

Response

Notes providing justification and hiring new employees at higher rates were available at the time of the audit, but were not summarized on the Department of Management and Budget's required form. Required forms have since been completed for those hires. Going forward, we will use the required form to summarize salary decisions.

Person Responsible: Bill Eisele, Administrative and Technology Services Director.

Estimated Implementation Date: Completed.

Finding 8. The Board of Water and Soil Resources did not require easement implementation program grantees to document their easement implementation costs.

Recommendation

- *The Board of Water and Soil Resources should develop procedures to ensure easement implementation program grantees use grants for easement implementation costs.*

Response

Our easement implementation grant program has documented the costs of delivering an easement and verifies the work performed through project completion. The amount we pay in reimbursement, \$2000 per easement, is based on a 1998 study that set expectations of grantee work and surveyed their costs. We know those costs have been incurred when we verify that the easement has been delivered.

We are now updating this survey by conducting a stratified sample of soil and water conservation districts to determine the costs of taking an easement based on the volume of easement transactions. We will conduct the survey periodically to ensure the reimbursement amount is sufficiently accurate and equitable. We will institute a process for grantees to certify that they used the money appropriately.

Since 1998, our expectations of the work performed by program grantees have not changed and payment amounts per easement have not increased. Documenting the costs of standardized, repetitive work through periodic surveys, and reimbursing local governments for those costs after verifying the work performed, is the most cost-effective way to deliver this important conservation program to the state.

Persons Responsible: Dave Weirens, Assistant Director, Programs and Policy; Bill Penning, Easements Section Manager.

Estimated Implementation Date: July 2015.

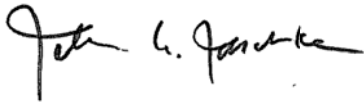
James R. Nobles, Legislative Auditor

February 19, 2015

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We value the work by the OLA staff to evaluate our internal controls and compliance, and we appreciate their professionalism and the respect they accorded our mission and that of our local partners to advance conservation in Minnesota. Please let me know if you have any questions.

Sincerely,

A handwritten signature in black ink, appearing to read "John G. Jaschke". The signature is written in a cursive style with a large initial "J".

John G. Jaschke
Executive Director

cc: Brian Napstad, BWSR Board Chair



Minnesota Pollution Control Agency

520 Lafayette Road North | St. Paul, Minnesota 55155-4194 | 651-296-6300

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February 18, 2015

Mr. James R. Nobles
Legislative Auditor
Office of the Legislative Auditor
Centennial Office Building, Room 140
658 Cedar Street
St. Paul, Minnesota 55155-1603

Dear Mr. Nobles:

Thank you for the opportunity to review and respond to the Office of Legislative Auditor's (OLA) findings and recommendations resulting from a recent audit of the Clean Water Fund for the Minnesota Board of Water and Soil Resources and the Minnesota Pollution Control Agency. We are committed to sound fiscal and program management, and the use of the Clean Water Fund to meet the requirements of the Federal Clean Water Act, the State Clean Water Legacy Act, and other legislative directives.

Further, we appreciate the professional review conducted by OLA staff, and have written a response to each audit finding and recommendation within your report that names our agency.

Finding #3: The Pollution Control Agency did not comply with state guidelines for allocating cost to its Clean Water Fund appropriations.

OLA Recommendation:

- *The Pollution Control Agency should allocate administrative costs to Clean Water Fund appropriations using the same indirect cost rate used for allocations to appropriations from other state funds.*
- *The Pollution Control Agency should improve its procedures to ensure it equitably allocate payroll costs to Clean Water Fund appropriations.*

Agency response: We generally agree with the OLA's recommendations concerning internal cost allocation rates, and agree with the recommendation concerning distribution of leave time to Clean Water Fund appropriations.

We believe ourselves to be generally in compliance with "MMB Guidance to Agencies on Legacy Fund Expenditures" when determining our cost allocation plans for charges to Clean Water Fund (CWF) appropriations. These guidelines allow for multiple cost allocation methods to ensure the efficient and appropriate use of all state monies. As we prepare our spending plan for FY 2016-17, we will continue to refine our cost allocation plan to make more transparent the process of allocating and direct charging costs to CWF appropriations.

Also, we will develop a process to review and reconcile paid leave time charges that result from actual billing through self-service time entry versus those which are automatically charged according to default ratios for persons eligible to be funded by multiple appropriations. We will work with Minnesota Management and Budget (MMB) toward improving the electronic self-entry payroll

system's accuracy in allocating leave time so it supports our use of multiple funding sources to implement programs.

Implementation Date: September 30, 2015

Responsible Manager: Lyle Mueller, Chief Financial Officer

Finding #4: The Board of Water and Soil Resources and the Pollution Control Agency paid \$3,500 and about \$25,000, respectively, from Clean Water Fund appropriations for activities that were not directly related to and necessary for the appropriations.

OLA Recommendation:

- *The Board of Water and Soil Resources and the Pollution Control Agency should process expenditure corrections to reallocate the expenditures to the proper appropriation.*
- *The Board of Water and Soil Resources and the Pollution Control Agency should strengthen procedures to ensure that they pay expenditures from the proper appropriations.*

Agency response: We agree in part with the OLA's recommendations.

Agency management maintains that the expense reimbursements submitted for required state travel and supplies costs by 43 employees whose salaries were paid from sources other than the Clean Water Funds were allowable as CWF expenses. In view of this OLA recommendation, we will review our guidance and documentation to ensure appropriate expenses are paid from CWF appropriations and charges for related agency activities are transparent to internal and external parties.

We agree with OLA findings that \$2,000 of reimbursements were to six employees whose payroll costs were paid from nonrelated CWF appropriations, and that those reimbursements were made in error. These charges occurred in the past biennium; it is not possible to make corrections to affected Clean Water Fund appropriations. We will strengthen procedures to ensure that expenditures are made from proper appropriations in the future.

Implementation Date: June 30, 2015

Responsible Manager: Lyle Mueller, Chief Financial Officer

Finding #5: The Pollution Control Agency and the Board of Water and Soil Resources did not accurately calculate certain nonroutine payroll payments to employees.

OLA Recommendation:

- *The Board of Water and Soil Resources and the Pollution Control Agency should make additional payments to employees to correct the underpayments and should collect overpayments from employees.*
- *The Board of Water and Soil Resources and the Pollution Control Agency should strengthen their procedures to ensure the accuracy of nonroutine payroll payments to employees.*

Agency response: We agree with the recommendation to ensure continuous accuracy in employee salary payments.

We will review auditor-identified instances of under and overpayments and take necessary steps to ensure that employee earnings are reconciled. To identify employees whose pay rates have changed during a pay period, we presently rely upon notification from our Human Resources section and/or monitor changes in negotiated employee agreements. We intend to develop a report that identifies changes in rates of pay by employee and pay period to ensure full accuracy of payroll payments.

We have corrected the one affected active service employee's compensation through a series of payments, the last of which was made on January 27, 2015. We will develop a policy for nonroutine payroll transactions that requires at least two persons to review the calculation in the future. We will also work with MMB to clarify and simplify guidance on making Military Salary Differential Payments.

Implementation Date: June 30, 2015

Responsible Manager: Lyle Mueller, Chief Financial Officer

Finding #6: The Board of Water and Soil Resources and the Pollution Control Agency did not comply with state requirements to ensure the integrity of employee time reporting and accuracy of payroll expenditures.

OLA Recommendation:

- *The Board of Water and Soil Resources and the Pollution Control Agency should review payroll reports in compliance with state policy.*
- *The Board of Water and Soil Resources and the Pollution Control Agency should not provide employees the ability to approve their own timesheets.*

Agency response: We generally agree with OLA recommendations.

As noted during audit work, we complete required reviews of Payroll Register reports for instances that necessitate follow-up, but are doing so in a manner that is paperless. The only documentation retained on payroll report review are those with an error code of 3 or higher, which was verified during testing. We will develop a paperless process to document instances where follow-up is not required.

We will also review our management decision to provide uniquely situated employees the ability to approve their own timesheets. Where this ability has been granted, our practice is to ensure that when the supervisor is available, the self-approved timesheet will be reviewed, signed and filed as documentation of that approval. A revised policy will be developed in consultation with our Human Resources section.

Implementation Date: June 30, 2015

Responsible Manager: Lyle Mueller, Chief Financial Officer

Finding #9: The Pollution Control Agency did not document its justification for advances of grant money from a Clean Water Fund appropriation to four Minnesota cities.

Mr. James R. Nobles

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February 18, 2015

OLA Recommendation:

- *The Pollution Control Agency should strengthen its procedures to ensure it documents its justification for advances of grant money in compliance with state policy.*

Agency response: We agree with OLA recommendations.

As noted during the audit process, we held internal deliberations on the appropriateness of advance grant payments, but did not maintain documentation of the justification within the grant file or in the grant agreements themselves. We will ensure that proper approval is maintained if future need of advance grant payments is determined.

Implementation Date: January 31, 2015

Responsible Manager: Lyle Mueller, Chief Financial Officer

Thank you again for the opportunity to respond. If you have any questions, please feel free to contact Chief Financial Officer Lyle Mueller at 651-757-2591, Lyle.Mueller@state.mn.us.

Sincerely,



John Linc Stine
Commissioner

JLS/JLB:kld