



FINANCIAL AUDIT DIVISION REPORT

**Minnesota Board of Water
and Soil Resources**

Internal Control and Compliance Audit

July 1, 2007, through December 31, 2009

May 27, 2010

Report 10-18

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OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

May 27, 2010

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Members of the Minnesota Board of Water and Soil Resources

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

This report presents the results of our internal control and compliance audit of the Minnesota Board of Water and Soil Resources for the period July 1, 2007, through December 31, 2009.

Our fieldwork ended on March 31, 2010, and we discussed the results of the audit with the Minnesota Board of Water and Soil Resources on May 13, 2010. The audit was conducted by Amy Jorgenson, CPA (Audit Manager) and Tracy Gebhard, CPA (Auditor-in-Charge), assisted by auditors Tracia Gimbut, Shanda Wilhelmy, and Anna Solomka.

This report is intended for the information and use of the Legislative Audit Commission and the management of the Minnesota Board of Water and Soil Resources. This restriction is not intended to limit the distribution of this report, which was released as a public document on May 27, 2010.

We received the full cooperation of the Minnesota Board of Water and Soil Resources' 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
Deputy Legislative Auditor

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Report Summary

Conclusion

The Board of Water and Soil Resources' internal controls were not adequate to ensure that it safeguarded its financial resources, accurately paid employees and vendors in accordance with management's authorizations, complied with finance-related legal provisions, and created reliable financial data. For the items tested, the board did not consistently comply with significant finance-related legal requirements for financial activity.

Key Findings

- Prior finding not resolved: The Board of Water and Soil Resources did not design, implement, or monitor internal controls to ensure that the board fulfilled its financial management responsibilities. ([Finding 1, page 7](#))
- The Board of Water and Soil Resources did not fully implement Office of Grants Management oversight policies. ([Finding 2, page 8](#))
- The Board of Water and Soil Resources' accounting practices compromised the integrity of its financial information in the state's accounting system. ([Finding 4, page 10](#))
- Prior finding partially resolved: The Board of Water and Soil Resources did not adequately safeguard or promptly deposit its receipts. ([Finding 5, page 12](#))
- The Board of Water and Soil Resources did not obtain appropriate authorization for some expenditures. ([Finding 6, page 13](#))
- The Board of Water and Soil Resources did not retain adequate documentation to support some of its transactions. ([Finding 8, page 15](#))

Audit Objectives and Scope

Objectives

- Internal Controls
- Compliance

Period Audited

July 1, 2007, through December 31, 2009

Audited Areas

- Select administrative expenditures
 - Appropriations and other funding
 - Payroll expenditures
 - Grant expenditures
 - Easement expenditures
-

Board of Water and Soil Resources

Agency Overview

In 1987, the Minnesota Legislature created the Minnesota Board of Water and Soil Resources. The board states as its mission “to improve and protect Minnesota’s water and soil resources by working in partnership with local organizations and private landowners.”¹

The board implements its mission by carrying out these statutory duties:

- Serving as the state soil conservation agency.
- Implementing best management practices that reduce pollution, promoting native vegetation and controlling invasive plant species by providing financial, technical, and administrative assistance to local government units and private landowners.
- Providing planning assistance to ensure that local water resource planning is linked with comprehensive land use planning and approving all local water management plans.
- Resolving water policy disputes.
- Implementing the comprehensive local water management acts.
- Providing a public forum for citizens and a broad range of interests to make decisions on complex water and soil conservation policies.
- Protecting wetlands from being drained or filled by implementing the Wetland Conservation Act.
- Coordinating local, state, and federal resources to achieve the most effective conservation outcomes for the state’s investment.

As required by statute, the board is composed of 20 members.² John Jaschke has been the board’s executive director since January 2007.

The board has employees throughout the state at nine field offices located in Bemidji, Brainerd, Duluth, Fergus Falls, Mankato, Marshall, New Ulm, Rochester, and Saint Paul (central office and metro field office).

The board received appropriations of \$68,069,000, \$20,994,000 and \$46,420,056 for fiscal years 2008, 2009, and 2010, respectively.³ In addition, it had revenue

¹ <http://www.bwsr.state.mn.us/>

² *Minnesota Statutes* 2009,103B.101, subd. 2.

³ The appropriations fluctuated significantly during fiscal years 2008, 2009, and 2010 because the board did not receive Clean Water Legacy appropriations for fiscal years 2009 and 2010, and the board received Reinvest in Minnesota easement appropriations in fiscal years 2008 and 2010.

from federal grants and interagency agreements, returned grant funds, and other sources that it used for its operations. Table 1 summarizes the board's revenues and expenditures for the period July 1, 2007, through December 31, 2009.

Table 1
Board of Water and Soil Resources
Revenues and Expenditures
July 1, 2007 – December 31, 2009

| Revenue: | Fiscal Years | | |
|---|---------------------|---------------------|-------------------------|
| | <u>2008</u> | <u>2009</u> | <u>2010¹</u> |
| Interagency Revenue | \$ 4,682,679 | \$ 4,360,749 | \$ 3,031,511 |
| Federal Revenue | 1,918,892 | 5,515,206 | 1,062,970 |
| Returned Grant Funds | 292,239 | 378,106 | 970,616 |
| Other Revenue | <u>0</u> | <u>145,152</u> | <u>178,644</u> |
| Total Revenue | <u>\$ 6,893,810</u> | <u>\$10,399,213</u> | <u>\$ 5,243,741</u> |
| Expenditures: | | | |
| Payroll | \$ 4,996,121 | \$ 5,868,759 | \$ 2,803,184 |
| Professional/Technical Services | 1,071,372 | 666,747 | 205,350 |
| Supplies, Equipment & Miscellaneous | 407,147 | 273,953 | 119,467 |
| Natural Resources Block Grants | 6,513,237 | 6,740,157 | 2,889,997 |
| Clean Water Legacy Grants | 6,952,551 | 4,392,772 | 141,169 |
| Cost Share Work Grants | 2,029,569 | 2,272,308 | 1,145,743 |
| Soil and Water Conservation District Services Grants | 3,557,609 | 3,558,325 | 3,491,070 |
| All Other Grants | 6,376,653 | 6,297,743 | 378,250 |
| Easements | 4,163,803 | 5,406,670 | 1,805,417 |
| All Other Expenditures | <u>944,879</u> | <u>1,049,567</u> | <u>433,970</u> |
| Total Expenditures | <u>\$37,012,941</u> | <u>\$36,527,001</u> | <u>\$13,413,617</u> |

¹Our scope included fiscal year 2010 activity through December 31, 2009.

Source: Minnesota Accounting and Procurement System.

Objectives, Scope, and Methodology

Our audit of the Board of Water and Soil Resources focused on the following audit objectives for its material financial activity during the period July 1, 2007, to December 31, 2009:

- Were the board's internal controls adequate to ensure that it safeguarded its financial resources, accurately paid employees and vendors in accordance with management's authorizations, complied with finance-related legal provisions, and created reliable financial data?
- For the items tested, did the board comply with significant finance-related legal requirements?
- Did the board resolve its prior audit findings?⁴

To meet the audit objectives, we gained an understanding of the board's financial policies and procedures. We considered the risk of errors in the accounting records and noncompliance with relevant legal requirements. We analyzed accounting data to identify unusual trends or significant changes in financial operations. In addition, we selected a sample of financial transactions and reviewed supporting documentation to test whether the controls were effective and if the transactions complied with laws, regulations, policies, and grant 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 objectives.

We used the guidance contained in the *Internal Control-Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission, as our criteria to evaluate the board's internal controls.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 internal policies and procedures as evaluation criteria over compliance.

⁴ Minnesota Office of the Legislative Auditor, Financial Audit Division Report 07-33, *Minnesota Board of Water and Soil Resources*, issued November 28, 2007.

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.

Conclusions

The Board of Water and Soil Resources' internal controls were not adequate to ensure that it safeguarded its financial resources, accurately paid employees and vendors in accordance with management's authorizations, complied with finance-related legal provisions, and created reliable financial data. For the items tested, the board did not consistently comply with significant finance-related legal requirements for financial activity.

The board did not fully resolve 6 of the 15 prior findings related to its financial management duties, and we repeat those findings in this report.

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

Findings and Recommendations

Finding 1

Prior finding not resolved:⁶ The Board of Water and Soil Resources did not design, implement, and monitor internal controls to ensure that the board fulfilled its financial management responsibilities.

The board did not assess the risks related to administering its financial responsibilities and failed to monitor the effectiveness of its internal controls. Findings 2 through 9 identify specific deficiencies in the board's internal controls; six of the findings are unresolved issues from our 2007 audit report. Although management had developed a corrective action plan to address the prior findings, it did not monitor the effectiveness of its plan and failed to detect that staff had not consistently applied internal controls. In aggregate, these weaknesses showed an overall lack of proper administrative oversight. Many problems resulted from an insufficient understanding of state policies and procedures and a lack of attention to detail by those with financial management responsibilities.

The state's policy on internal control requires that each agency head identify, analyze, and manage business risks that affect the entity's ability to maintain its financial strength and the overall quality of its products and government services.⁷ The policy further requires follow-up procedures that, at a minimum, should include ways to monitor controls and report significant deficiencies to individuals responsible for the process or activity involved, including executive management and those individuals in a position to take corrective action.

Recommendations

- *The board should identify its financial risks, including the risk of noncompliance with finance related legal requirements, develop internal controls to mitigate those risks, and monitor the effectiveness of its internal controls on an on-going basis.*
- *The board should provide adequate training and oversight for its accounting personnel to ensure they adequately perform their financial management responsibilities.*

⁶ Minnesota Office of the Legislative Auditor, Financial Audit Division Report 07-33, [Minnesota Board of Water and Soil Resources](#), Finding 1, issued November 28, 2007.

⁷ Department of Management and Budget Policy 0102-01, *Internal Control*, revised May 11, 2006.

Finding 2

The Board of Water and Soil Resources did not fully implement Office of Grants Management oversight policies.

The board did not have adequate internal controls to ensure that grantees spent funds in accordance with grant agreements. The board had the following weaknesses in its oversight of the grant programs we reviewed:

- The board did not timely reconcile granted funds to actual grantee expenditures, as required by state policy.⁸ The board generally paid the total amount of the grant at the start of the grant period and allowed grantees two to four years to spend the funds, with additional time to complete and submit final reports. State policy requires a granting agency to reconcile advance grant payments within 12 months of the beginning of the grant.⁹ However, for some grants, board staff primarily relied on close out reports, typically received more than two years after the beginning of the grant period, to determine the appropriateness of expenditures. For Cost Share Work Grants, the board's internal policy required grantees to submit close out reports within four and a half years of the start of the grant. However, board staff miscalculated the deadline and allowed recipients five and a half years to close out the grants, potentially delaying the board's verification of expenditures and determination of any funds the grantee needed to return.
- The board did not have standardized procedures or documented evidence to substantiate grant monitoring activities.¹⁰ The board stated that its staff frequently visited or otherwise communicated with various grantees. Without documentation, the board was unable to show that it had included an examination of the grantee's financial records as part of its monitoring visits.
- Although the board required grantees to periodically report expenditures through an electronic system it developed, the reports did not contain sufficient detail to determine the appropriateness of the expenditures. The grantees reported total amounts expended, with no breakdown of the types of expenditures, such as payroll or rent. The electronic reporting system also did not indicate if board staff reviewed or approved the reports.

The Office of Grants Management policies became effective during fiscal year 2009. The board implemented many of the policies, but needs to do additional work to be compliant with the policies cited in this finding.

⁸ Office of Grants Management Policy 08-08 and 08-10.

⁹ Office of Grants Management Policy 08-08.

¹⁰ Recommended by Office of Grants Management Policy 08-10.

Recommendations

- *The board should reconcile grant recipients' actual expenditures in a timely manner to ensure that the grantees used the funds in accordance with the grant agreements, as required by state policies.*
- *The board should revise the due dates for the Cost Share Work Grant close out reports to comply with the deadline required by the board's policy.*
- *The board should formalize its grant oversight procedures, including the procedures used to conduct and document financial monitoring visits.*
- *The board should enhance its electronic reporting system so that it has sufficient detail about grant recipients' expenditures and has evidence of review or approval of the expenditure reports.*

The Board of Water and Soil Resources did not have adequate controls to track the receipt of annual monitoring reports for wetland restorations added to the wetland bank.

Finding 3

The board did not have evidence to show it directly obtained the required annual monitoring reports for four of six wetland restorations tested. State rule requires that the board's wetland banking administrator receive annual reports for the first several years of a project.¹¹ In August 2009, the board adopted a new state rule that allowed it to prevent the deposit of credits or freeze the account until the board received the required monitoring report.¹² Board staff recognized the need to document the receipt of the annual monitoring reports; however, they had not fully implemented procedures to address the new enforcement rules. The board determined that 46 wetland bank monitoring reports were prepared in 2009. The board did not know how many it directly received.

Recommendation

- *The board should directly obtain and implement procedures to track the receipt of annual monitoring reports so that it can take appropriate enforcement action for those it does not receive.*

¹¹ Minnesota Administrative Rule 8420.0810.

¹² Minnesota Administrative Rule 8420.0735.

Finding 4

The Board of Water and Soil Resources' accounting practices compromised the integrity of its financial information in the state's accounting system.

The board failed to accurately record transactions totaling about \$11 million in the state's accounting system. Board management failed to provide appropriate guidance, oversight, and monitoring to ensure it accurately recorded transactions. The prevalence and significance of these errors made it difficult to determine whether it used funds for the intended purposes.

The lack of attention to the accuracy of financial information recorded in the state's accounting system led to the following errors:

- For the items tested, the board deposited \$282,765 of revenue into and paid \$336,691 of expenditures out of the wrong appropriation accounts in the state's accounting system, as shown in Table 2.

Table 2
Board of Water and Soil Resources
Erroneously Recorded Revenues and Expenditures
July 1, 2007 – December 31, 2009

| <u>Appropriation Account</u> ¹ | <u>Incorrect Receipts</u> | <u>Incorrect Expenditures</u> |
|---|---------------------------|-------------------------------|
| Department of Transportation Interagency | \$ 23,756 | \$ 0 |
| Department of Natural Resources Interagency | 121 | 0 |
| Wetland Banking Fees | 20,852 | 0 |
| Clean Water Legacy Grants | 10,865 | 10,000 |
| Wetland Refinement | 130,500 | 40,000 |
| Pollution Control Agency Interagency | 67,605 | 61,000 |
| Natural Resources Block Grants | 11,380 | 164,482 |
| Cost Share Work Grants | 17,686 | 0 |
| Army Compatible Use Buffer Federal Grant | 0 | 27,059 |
| Zumbro Watershed Partnership | 0 | 9,000 |
| Great Lakes Commission Grant | 0 | 25,150 |
| Total Errors | <u>\$282,765</u> | <u>\$336,691</u> |

¹These appropriation accounts represent various interagency agreements, federal grants, and legislatively mandated grant funds.

Source: Auditor determined using Minnesota Accounting and Procurement System and board records.

- For receipts totaling about \$9.3 million, the board used a revenue source code that did not correctly identify the funding source in the state's accounting system.¹³ For example, in several instances, totaling about \$6.9 million, it incorrectly identified receipts from the federal government

¹³ Department of Management and Budget policy 0208-01.

as reimbursements from another state agency. Other errors occurred when it used a default code rather than adjusting the code to correctly identify the source of funds.

- The board recorded \$537,031 returned grant funds in the state's accounting system as reductions of expenditures instead of as revenue.¹⁴
- The board improperly accounted for an interagency agreement with the Minnesota Pollution Control Agency for County Feedlot grants in the state's accounting system. There were four amendments to the board's interagency agreement with the Minnesota Pollution Control Agency. Instead of reducing the revenue for these amendments, as required by state policy, the board adjusted the expenditures resulting in a \$150,100 overstatement of revenues and expenditures.¹⁵ The board also recorded an \$18,800 receipt of revenue as a reduction of expenditures resulting in an understatement of revenues and expenditures.
- The board did not properly monitor its interagency receivables. As a result, it had nearly \$53,000 of invalid outstanding receivables as of February 2010.¹⁶ Although the board had received the revenue associated with its interagency agreements, it had not eliminated the receivables in the state's accounting system. State policy requires agencies to review transactions to ensure receivable activity was properly recorded.¹⁷ The board did not establish any monitoring activities to ensure that it properly cancelled all receivables when appropriate.
- For expenditures totaling nearly \$140,000, the board used an expenditure object code that did not correctly identify the type of services, materials, or other charges for payments it made in the state's accounting system.¹⁸
- Prior finding partially resolved:¹⁹ For expenditures totaling \$253,000, the board did not correctly identify in the state's accounting system the date of the state's liability for the expenditure. Board staff incorrectly recorded the liability date for 8 of the 21 expenditures we tested. Although the board changed its process since the last audit, it continued to have errors. State policy requires that the board ensure the liability date corresponds to the date it received the goods or services.²⁰

¹⁴Government Accounting Standards Board Statement 33, paragraph 26, requires that returned prior year grant funds be reported as revenue in the year returned.

¹⁵ Department of Management and Budget policy 0503-01.

¹⁶ The board had three invalid outstanding receivables from fiscal years 2005, 2006, and 2008.

¹⁷ Department of Management and Budget policy 0810-01.

¹⁸ Department of Management and Budget policy 0207-01.

¹⁹ Minnesota Office of the Legislative Auditor, Financial Audit Division Report 07-33, *Minnesota Board of Water and Soil Resources*, Finding 7, issued November 28, 2007.

²⁰ Department of Management and Budget policy 0901-01.

Recommendations

- *The board should properly record transactions in the state's accounting system to provide an accurate record of financial activity.*
- *The board should examine financial records not tested during our audit to identify and correct other inaccuracies.*
- *The board should monitor interagency receivables to ensure proper reporting of amounts due.*

Finding 5

Prior finding partially resolved:²¹ The Board of Water and Soil Resources did not adequately safeguard or promptly deposit some receipts.

The board had the following significant internal control weaknesses for certain receipts:

- The board did not adequately separate incompatible duties for returned grant fund receipts: The person who initially received the checks also prepared the deposit.
- The board did not adequately safeguard or promptly deposit receipts for wetland banking and wetland conservation act appeal fees. Employees kept the receipts in unlocked file cabinets until the board had received and verified all documents related to the transaction. The board did not have a log of its undeposited receipts. In March 2010, we found six checks in the files totaling about \$5,000; one check dated back to 2006. Holding checks for long periods increases the risk that they could be lost or stolen, or that they may become non-negotiable. For example, in February 2010, the board deposited a \$1,000 check it had received in August 2009. The bank returned the check because the account was closed.

Separation of incompatible duties and safeguarding of receipts are fundamental internal controls to protect receipts from loss or theft. Statutes require state agencies to deposit receipts greater than \$250 within one day.²² State policy details an effective receipt and deposit process.²³

²¹ Minnesota Office of the Legislative Auditor, Financial Audit Division Report 07-33, *Minnesota Board of Water and Soil Resources*, Finding 5, issued November 28, 2007.

²² *Minnesota Statutes* 2009, 16A.275.

²³ Department of Management and Budget policy 0602-03.

Recommendations

- *The board should adequately separate duties and follow state policies designed to safeguard receipts.*
- *The board should deposit receipts totaling \$250 or more on a daily basis, as required by statute.*

The Board of Water and Soil Resources did not obtain appropriate authorization for some expenditures.**Finding 6**

The board did not properly execute two contracts. The board entered into a \$20,490 contract for a watershed web project without obtaining the signature of the Commissioner of Administration. The board also used a maintenance agreement instead of a professional/technical contract for \$30,000 of software maintenance services. State statute requires the board to obtain approval from the commissioner of Administration for all contracts exceeding \$5,000.²⁴

The board also set the initial pay rate for two employees higher than allowed without obtaining authorization from the Department of Management and Budget, as required by *Minnesota Administrative Rules*.²⁵ It hired an assistant director at a salary ten percent higher than allowed without authorization, and hired another employee at a pay rate two “steps” higher than allowed without authorization. Once we informed the board about the issue, staff submitted the necessary documentation to the Department of Management and Budget and obtained retroactive approval.

The board also failed to obtain proper approval for 3 of 12 special expense transactions we tested. Special expense forms document specific approval for expenses that are only allowable under certain circumstances. The three transactions, totaling about \$13,200, were for food purchases and conference costs related to board meetings and training events. Board staff had prepared special expense forms for two of the transactions, but the forms lacked proper approval. Staff had not prepared a special expense form for the third transaction. State policy requires that personnel with the proper authoritative position or proper delegation must approve special expense requests.²⁶

²⁴ *Minnesota Statutes* 2009, 16C.08.

²⁵ *Minnesota Administrative Rules* 3900.2100.

²⁶ Department of Administration policy FMR-4D-01.

Recommendations

- *The board should ensure that it fully executes all contracts, including authorization from the Department of Administration.*
- *The board should obtain and document appropriate authorization before hiring employees at an increased pay rate.*
- *The board should complete the necessary special expense documentation and only allow appropriate personnel to authorize special expenses.*

Finding 7

Prior finding partially resolved:²⁷ The Board of Water and Soil Resources did not sufficiently review a key report to ensure the accuracy of payroll transactions.

The board did not follow up on exceptions identified in a key payroll report that evaluates data entered into the state's self service time entry system. State policy requires review of the exception report.²⁸ It is the responsibility of the supervisor to review time reports for accuracy.²⁹

Since our last audit, the board reduced the number of exceptions listed on the payroll report. For the seven pay periods tested, the report identified 28 timesheets authorized by a back up approver and 126 timesheets not completed by the employee. However, the board failed to follow up on these exceptions. The policy requires the board to resolve any exceptions noted on the report. For each of the exceptions, the board should have validated the reported hours with the employee or the primary supervisor, as appropriate. Adding to the control weaknesses, the board assigned two employees as back up approvers for personnel at other locations. These two employees had no direct knowledge of the work those personnel performed.

In the state's payroll process, an agency's key responsibility is to ensure that the state pays for hours worked. Without following up on exceptions identified within the key payroll report, the board cannot demonstrate that it has fulfilled its duties and complied with state payroll policies.

²⁷ Minnesota Office of the Legislative Auditor, Financial Audit Division Report 07-33, *Minnesota Board of Water and Soil Resources*, Finding 2, issued November 28, 2007.

²⁸ Department of Management and Budget policy PAY0016, *Biweekly Time Reporting by Employees*.

²⁹ Department of Management and Budget policy PAY0017, *Employee Self Service Time Entry*.

Recommendations

- *The board should follow up on time reporting exceptions on the self service time entry audit report.*
- *The board should periodically review and update its list of payroll backup approvers to ensure they are appropriate.*

The Board of Water and Soil Resources did not retain adequate documentation to support some of its transactions.**Finding 8**

The board did not retain appropriate documentation to support the hiring salary of certain employees. Instead, board management relied on the Department of Management and Budget to retain the approval documentation. State policy requires the board to retain the approval documentation for four years after the employee's separation date.³⁰

In addition, for three of eight items tested, the board did not retain documentation to support appropriation transfers. State policy requires the board to retain the documentation (Anticipated Transfer of an Appropriation Form) to support the transaction.³¹ Again, board management relied on the Department of Management and Budget to retain this documentation.

Recommendation

- *The board should maintain adequate and required documentation to support its transactions.*

Prior finding partially resolved:³² The Board of Water and Soil Resources lacked effective controls over fixed assets and sensitive items, as required by state guidelines.**Finding 9**

The board did not complete a physical inventory: It did not verify the existence of two inventory items during the fiscal year 2009 physical inventory count and 18 inventory items during the fiscal year 2010 physical inventory count. In addition, the board did not review physical inventory documentation to ensure accuracy and completeness. The equipment inventory records included both capital and

³⁰ Department of Management and Budget Statewide Human Resources Retention Schedule 06-137.

³¹ Department of Management and Budget policy number 0307-01.

³² Minnesota Office of the Legislative Auditor, Financial Audit Division Report 07-33, [Minnesota Board of Water and Soil Resources](#), Finding 9, issued November 28, 2007.

sensitive assets.³³ From July 2007 through December 2009, purchases of these items totaled about \$400,000.

The board had the following weaknesses in its inventory management practices:

- The board failed to adequately segregate incompatible inventory duties. The employee who maintained the inventory database also conducted the physical inventory of some sensitive items in fiscal year 2009. The risk of errors and fraud increased when employees responsible for maintaining the inventory records also conducted the physical inventory.
- The board's inventory records did not contain all information required by state guidelines.³⁴ The records did not specify the description of the asset, model number, purchase order number, and a date of disposal. In addition, records did not specify the physical location and custodian for all items. In some instances, the board did not assign custody to inventory items. The board also recorded one tested inventory item twice on the records, and one asset number listed on the records was not associated with any item. Without complete and accurate information, it is difficult to authenticate an asset during a physical inventory count.
- The board did not have an internal policy regarding inventory. State guidelines require each agency to establish and publish its departmental policy for accounting for fixed assets and inventory.³⁵ The policy must indicate the staff responsible for inventory, the procedures used to conduct physical inventory, the procedures for tracking assets, and the procedures to maintain and implement good internal controls over fixed assets.

Recommendations

- *The board should segregate record keeping and physical inventory functions.*
- *The board should design and implement controls to ensure:*
 - *Accuracy and completeness of all physical inventory counts.*
 - *Inclusion of required information on inventory records.*
 - *Adequate monitoring over inventory management.*
- *The board should ensure compliance with state guidelines by establishing internal policy for inventory management practices.*

³³ Capital assets include property that costs \$5,000 or more, has a normal useful life expectancy exceeding two years, and maintains its identity while in use. Sensitive assets are items that are generally for individual use or could be easily sold and are most often subject to theft or misuse.

³⁴ Department of Administration User's Guide to State Property Management, section 5.

³⁵ Department of Administration User's Guide to State Property Management, section 14.



Comments on the Board of Water and Soil Resources' Response

In its response to finding 2, the board stated, “*We have program and organization review mechanisms in place to assure and document that the grants for these programs are being used for the intended purposes and results.*”

We examined the mechanisms the board had in place for the time period of our audit and found them inadequate. The interim reports the board required during grant periods did not contain enough information to determine how the grantee actually used the funds; the reports simply stated the total expended without additional explanation. Furthermore, the board did not document that it used the interim reports to monitor how grantees used grant resources or how its grantee monitoring visits provided oversight of financial matters.

The board’s grant close out reviews were thorough, but occur so long after the funds were granted (usually between two to four years) that they did not provide timely accountability. The Office of Grants Management Policy 08-08 requires heightened grant oversight when making payments in advance; it specifically requires that the granting agency reconcile all advance payments within 12 months of the beginning of the grant period. The board’s lack of timely, documented reviews of grantees’ use of grant funds resulted in our conclusion that the board did not have sufficient controls to ensure that its grants were being used for the intended purposes.

Also in its response to finding 2, the board stated that it disagreed with our recommendation that it should revise the due dates for the Cost Share Work Grant close out reports to comply with the deadline required by the board’s policy. The response fails to recognize that while the board’s policy requires submission of close out reports within four and one half years of the grant award, board staff established instructions that allowed due dates up to five and one half years after the grant award.

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May 27, 2010



May 25, 2010

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

Dear Mr. Nobles;

Please accept this correspondence as the Board of Water and Soil Resources' (BWSR) response to the findings and recommendations included in the draft report of the internal control and compliance audit conducted by your office for the period July 1, 2007 to December 31, 2009.

For each recommendation we have noted the response, person(s) responsible for resolving the finding, and the estimated completion date of the action planned.

Finding 1: Prior finding not resolved: The Board of Water and Soil Resources did not design, implement, and monitor internal controls to ensure that the board fulfilled its financial management responsibilities.

Recommendation: The board should identify its financial risks, including the risk of noncompliance with finance related legal requirement, develop internal controls to mitigate those risks, and monitor the effectiveness of its internal controls on an on-going basis.

Response: We agree with the recommendation. While we implemented many of the internal control policies as they were established by Minnesota Management and Budget (MMB) over the last year and conducted the required training, we will go further to integrate these policies into all areas of financial management. We acknowledge the heightened attention for internal control and will consult with the newly established MMB Internal Control Unit as we move forward.

Person Responsible: John Jaschke and Executive Team

Estimated Completion Date: Ongoing, with a six-month goal of December 2010 for the majority of policy changes to be in place.

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Recommendation: The board should provide adequate training and oversight for its accounting personnel to ensure they adequately perform their financial management responsibilities.

Response: We agree with the recommendation. We have conducted internal control training per the MMB schedule for both fiscal staff and senior management. However, regular training and refresher training for fiscal staff will be more targeted and frequent in the future.

Person Responsible: John Jaschke and William Eisele

Estimated Completion Date: Training will be ongoing, with the goal to have an identified schedule to coincide with December 2010 timeline stated above.

Finding 2: The Board of Water and Soil Resources did not fully implement Office of Grants Management oversight policies.

Response: We agree with this finding, however we believe there is an inconsistency between the finding and the introduction to the described weaknesses. The finding is specific to the Board's compliance with the Office of Grants Management (OGM) policies, while the introduction speaks very broadly about the lack of adequate internal controls. We have program and organizational review mechanisms in place to assure and document that the grants for these programs are being used for the intended purposes and results.

The Office of Grant Management (OGM) policies were adopted midway through the audit period and the Board has made significant investments in complying with them, and these efforts are continuing. Currently, the Board and its grant programs are in compliance with all policies except for portions of 08-08: Policy on Grant Payments and 08-10: Policy on Grant Monitoring. In response to enactment of these policies, a staff team will be developing proposed policies and procedures to comply with the monitoring and financial reconciliation requirements of these policies and to increase the efficiency of agency grant monitoring and oversight responsibilities.

Person Responsible: David Weirens

Estimated Completion Date: May 2011

Recommendation: The board should reconcile grant recipients' actual expenditures in a timely manner to ensure that the grantees use the funds in accordance with the grant agreements as required by state policies.

Response: We agree with this recommendation to the extent it addresses our compliance status with OGM policies. The initial response above under Finding 2 discusses this issue and our approach to develop effective and compliant policies and procedures. However, more discussion over this recommendation is warranted. Board grant agreements are generally for two years, thus we are concerned over the inherent inefficiencies in conducting financial reconciliations before a grant agreement has expired. Grants are regularly monitored in that grantees are required to report on grant status twice annually. Board staff will discuss this policy further with the OGM.

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Person Responsible: David Weirens

Estimated Completion Date: September 2010

Recommendation: The board should revise the due dates for the Cost Share Work Grant close out reports to comply with the deadline required by the board's policy.

Response: We do not agree with this recommendation and have never interpreted or applied this policy as described in the finding. The referenced Board policy was instituted following the prior audit and has been in effect for approximately 2 years.

Person Responsible: David Weirens

Estimated Completion Date: December 2010 and May 2011

Recommendation: The board should formalize its grant oversight procedures including the procedures used to conduct and document financial monitoring visits.

Response: We agree in part and disagree in part with this recommendation. The Board currently has a variety of grant oversight, monitoring, and closeout policies and procedures that comply with the OGM policy 08-10. However, these policies and procedures are not uniformly applied to all grant programs in a manner that is compliant with the OGM policy. We do agree with the value of formalizing grant oversight consistent with OGM policy 08-10 and the staff work team mentioned above will develop recommendations to accomplish that goal to the extent practical.

Person Responsible: David Weirens

Estimated Completion Date: May 2011

Recommendation: The board should enhance its electronic reporting system so that it has sufficient detail about grant recipients' expenditures and has evidence of review or approval of the expenditures reports.

Response: We agree in part and disagree in part with this recommendation. The eLINK reporting system has the capability to document Board staff review and approval of project workplans and reports. This functionality will be applied to all appropriate staff responsibilities for grant oversight in this system.

However, eLINK is primarily intended to be a system for grantees to provide data on the outcomes of state financed projects and activities. It has never been intended to be an accounting system with the level of detail described in the finding. Detail on expenditures are reviewed as part of existing grant close-out procedures.

Person Responsible: David Weirens and Tim Ogg

Estimated Completion Date: December 2010

Finding 3: The Board of Water and Soil Resources did not have adequate controls to track the receipt of annual monitoring reports for wetland restorations added to the wetland bank.

Recommendation: The board should directly obtain and implement procedures to track the receipt of annual monitoring reports so that it can take appropriate action for those it does not receive.

Response: We partially agree with the finding and agree with the recommendation. The audit has identified an issue regarding documentation of the direct receipt of wetland bank monitoring reports. As required by the Wetland Conservation Act 2002 permanent rule, and the 2007 exempt rule, BWSR received these reports as part of the wetland bank credit allocation process (membership on the technical evaluation panel). The permanent Wetland Conservation Act rule adopted in August 2009, establishes the need to document direct receipt of wetland bank monitoring reports as a copy is required to be sent to the BWSR wetland bank administrator. The existing database that manages the deposit and withdrawal of wetland credits has the capability to track the receipt of annual monitoring reports, along with other relevant information. This functionality of the aforementioned database will be employed to document receipt of wetland bank monitoring reports as required by rule. BWSR also has a systematic field verification and inspection program for wetland banks. This program advises the Board on bank account status.

Person Responsible: David Weirens

Estimated Completion Date: November 2010

Finding 4: The Board of Water and Soil Resources' accounting practices compromised the integrity of its financial information in the state's accounting system.

Recommendations: The board should properly record transactions in the state's accounting system to provide an accurate record of financial activity.

Response: We agree with the recommendation. As a general follow up, we will consult with the internal control specialists in Minnesota Management and Budget (MMB) on processes they suggest to improve accuracy. Regarding the specific error types detailed in the audit: Revenue errors: We have constructed a table of the standard BWSR revenue sources to use to cross check against all revenue items that come in. Incoming revenue will require a supervisor review of the proposed account coding. Expenditure errors: Some trace to an error in the front-end on the receipt, which will be addressed with dual receipt review. During the audit we developed a new grant encumbrance authorization process that requires two people to approve coding of grant encumbrances to address potential incorrect coding of grant expenditures. Receipt errors: See process described under "Revenue errors". However, there will always be some judgments as to which revenue source codes are the most appropriate. Returned grant funds: A process was instituted in May 2008 under direction from Minnesota Management and Budget that corrected this exception. We do not agree that the audit report should have counted returned grant funds prior to that date. Expenditure codes: We do not agree with all of the exceptions as they were primarily in two areas of expenditure and thus training of staff is the best way to

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reinforce consistency with the preferred codes. We will develop a list of usual codes for BWSR and conduct staff training to review the types of transactions where each should be used.

Person Responsible: William Eisele

Estimated Completion Date: November 2010

Recommendations: The board should examine financial records not tested during our audit to identify and correct other inaccuracies.

Response: We agree with the recommendation. In conjunction with the normal year-end review process, all funds and sub funds will be reconciled, including those that were not scrutinized during the audit. The year end process will include an additional review level (Assistant Director) to assure timely certification.

Person Responsible: William Eisele and Assistant Director Julie Blackburn

Estimated Completion Date: September 2010

Recommendations: The board should monitor interagency receivables to ensure proper reporting of amounts due.

Response: We agree with the recommendation. During the audit, the auditor-in-charge noted that the state accounting system has a report that can be used to monitor the amounts due. Use of this report was instituted at the beginning of May when the supervisor reviewed April expenditures. The accountant was instructed to include this report in the normal month end process going forward and this will be written in the receivables policy.

Person Responsible: William Eisele

Estimated Completion Date: July 2010

Finding 5: Prior finding partially resolved: The Board of Water and Soil Resources did not adequately safeguard or promptly deposit some receipts.

Recommendations: The board should adequately separate duties and follow state policies designed to safeguard receipts.

Response: We agree with the recommendation. We had changed our deposit procedure significantly after the last audit, including adding a separation of duties. However a step will be added at the beginning of the process to include a manual log to document deposits. We will also develop a policy that covers all aspects of this function.

Person Responsible: William Eisele

Estimated Completion Date: July 2010

Recommendations: The board should deposit receipts totaling \$250 or more on a daily basis, as required by statute.

Response: We agree with the recommendation. There were two areas of BWSR that receive checks that were handled "outside" the normal deposit process. During the audit we changed the procedure so that checks for these two areas, appeals and banking, are treated like all others. The written policy noted under the first recommendation for this finding will specifically refer to those two areas and how their receipts should be handled.

Person Responsible: William Eisele

Estimated Completion Date: July 2010 (Procedure is in place but written policy must be completed)

Finding 6: The Board of Water and Soil Resources did not obtain appropriate authorization for some expenditures.

Recommendations: The board should ensure that it fully executes all contracts including authorization from the Department of Administration.

Response: We agree with the recommendation. An internal review has determined that utilizing an existing contract checklist available from the Department of Administration will remove exceptions related to missed signatures. We will document this in internal contract processing requirements. An agreement for a specific type of activity (computer maintenance) was developed as a service contract. In the future these activities will be treated as a professional technical contract.

Person Responsible: William Eisele

Estimated Completion Date: August 2010 (For documented procedure)

Recommendations: The board should obtain and document appropriate authorization before hiring employees at an increased pay rate.

Response: We agree with the recommendation. As noted in the audit we did receive retroactive approval. We have now added a checklist to accompany the new hire process in order to remind the appropriate staff when the salary approval (or any other applicable approvals) is needed.

Person Responsible: William Eisele

Estimated Completion Date: In place May 2010

Recommendations: The board should complete the necessary special expense documentation and only allow appropriate personnel to authorize special expenses.

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Response: We agree with the recommendation. We have provided the three regional supervisors formal authority to approve special expense requests for their staff via written delegation. Periodic refresher training with staff will address the instance of the one missing authorization.

Person Responsible: William Eisele

Estimated Completion Date: August 2010 (To conduct training)

Finding 7: Prior finding partially resolved: the Board of Water and Soil Resources did not sufficiently review a key report to ensure the accuracy of payroll transaction.

Recommendations: The board should follow up on time reporting exceptions on the self service time entry audit report.

Response: We agree with the recommendation but do not agree with the implication of the audit findings that supervisors are not reviewing time sheets in instances where they did not directly approve the timesheet in the electronic system or that the agency cannot ensure that the state pays for hours worked. When a supervisor is not physically available to do the electronic sign off of a timesheet of an employee they supervise, so that the sign off is done by a backup, it is the responsibility of the supervisor to go back and make sure they agree with the submitted hours. In order to eliminate the auditor's concerns, we are now requiring the supervisor to physically sign off on a report in permanent files that they did review the time sheet after the fact. This policy was instituted in April 2010. We have retrained supervisors to remind them of the need to limit the times where a back up approver is necessary. This will become part of an updated policy.

Person Responsible: William Eisele

Estimated Completion Date: July 2010 (For policy documentation)

Recommendations: The board should periodically review and update its list of payroll backup approvers to ensure they are appropriate.

Response: We agree with the finding and believe the agency has and will continue to comply with this recommendation. We established a necessary level of back up approvers to ensure efficient processing of payroll and have pared that to reduce potential exceptions. Our updated policy will include an annual documented review by the Assistant Director.

Person Responsible: William Eisele and Julie Blackburn

Estimated Completion Date: July 2010 (For policy documentation)

Finding 8: The Board of Water and Soil Resources did not retain adequate documentation to support some of its transactions.

Recommendations: The board should maintain adequate and required documentation to support its transactions.

Response: We agree with the recommendation. There were two specific areas cited, both of which related to approvals received from Minnesota Management and Budget (MMB), one being the area of salary approval for new hires and the other the area of approval of appropriation transfers in the state accounting system. In both cases we received the necessary approvals and the processes were not in question, plus back up documentation was readily available from MMB. However we understand the recommendation to also have duplicate documentation in agency files, because that is what MMB policy requires. We have had two appropriation transfers processed since the audit and in both cases made a point to establish a full paper backup file. For the new hire salary approval, we had documentation of the missing approvals re-sent from MMB and put it in agency files. For future hires we have established a checklist (see Finding 6) that will note when duplicate records retention is needed.

Person Responsible: William Eisele

Estimated Completion Date: In place May 2010

Finding 9: Prior finding partially resolved: The Board of Water and Soil Resources lacked effective controls over fixed assets and sensitive items, as required by state guidelines.

Recommendations: The board should segregate record keeping and physical inventory functions.

Response: We agree with the recommendation. We will develop a system that separates the inventory documentation from the physical inventory process. We have not yet decided how best to do this. Once determined, it will be documented in agency policy.

Person Responsible: William Eisele

Estimated Completion Date: November 2010

Recommendations: The board should design and implement controls to ensure:

- *Accuracy and completeness of all physical inventory counts.*
- *Inclusion of required information inventory records.*
- *Adequate monitoring over inventory management.*

Response: We agree with the recommendation. When the policy is designed on how to improve inventory, we will update the existing inventory data base to include the missing fields. The annual process will be strengthened by following up on all exception items noted. We will include this in the agency policy documentation.

Person Responsible: William Eisele

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Estimated Completion Date: November 2010

Recommendations: The board should ensure compliance with state guidelines by establishing internal policy for inventory management practices.

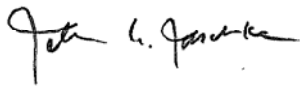
Response: We agree with the recommendation. The agency will adopt its own policy consistent with Department of Administration policy and conduct training for parties involved.

Person Responsible: William Eisele

Estimated Completion Date: November 2010

This concludes the agency response. We want to acknowledge the high degree of professionalism demonstrated by your staff during the audit research work conducted in our offices and in the follow-up effort to prepare the report. Please let me know if you have any questions.

Sincerely,

A handwritten signature in black ink, appearing to read "John G. Jaschke".

John Jaschke
Executive Director

cc: Randy Kramer, Board Chair