



FINANCIAL AUDIT DIVISION REPORT

Petroleum Tank Release Cleanup Fund

Internal Controls and Compliance Audit

July 1, 2008, through March 31, 2012

November 1, 2012

Report 12-22

FINANCIAL AUDIT DIVISION

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

November 1, 2012

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This report presents the results of our internal controls and compliance audit of the Petroleum Tank Release Cleanup Fund for the period July 1, 2008, through March 31, 2012.

We discussed the results of the audit with staff at the respective departments in October 2012. This audit was conducted by Brad White, CPA, CISA, CFE (Audit Manager) and Joan Haskin, CPA, CISA, (Auditor-in-Charge), assisted by auditors Cindy Gaertner, CPA, Kelsey Nistler, and Margaret Sullivan.

We received the full cooperation of staff from the state agencies while performing this audit.

James R. Nobles
Legislative Auditor

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

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Report Summary

Conclusion

The internal controls over Petroleum Tank Release Cleanup Fund (the fund) expenditures by the Department of Commerce, the Department of Employment and Economic Development, and the Pollution Control Agency were generally adequate to ensure that they safeguarded the fund's financial resources, accurately paid claimants and remediation costs in accordance with management's authorization, complied with finance-related legal requirements contained in statutes, laws, rules, and agency policies, and created reliable financial data. For the items tested, the agencies generally complied with significant finance-related legal requirements.

However, the Department of Employment and Economic Development had some internal control weaknesses and instances of noncompliance, as discussed in the report's finding.

Finding

- The Department of Employment and Economic Development's contamination cleanup grants did not always comply with some policies. ([Finding 1, page 7](#))

Audit Objectives and Scope

Objectives

- Internal Controls
- Legal Compliance

Period Audited

July 1, 2008 through March 31, 2012

Areas Audited

Petroleum Tank Release Cleanup Fund:

- Department of Commerce
 - Department of Employment and Economic Development
 - Pollution Control Agency
-

Petroleum Tank Release Cleanup Fund Overview

The Minnesota Legislature created the Petroleum Tank Release Compensation Board (the board) and the Petroleum Tank Release Cleanup Fund (the fund) in 1987 to provide financial assistance to owners and operators of underground petroleum storage tanks.¹ Underground petroleum storage tanks can corrode over time, resulting in leaks that can contaminate soil and groundwater. The board protects the state from this contamination by overseeing the petroleum tank release cleanup program, paid for through the fund. The board is composed of a public member, a claims-adjustment expert, a representative of the petroleum industry, and the commissioners of the Department of Commerce and the Pollution Control Agency.²

The fund received its primary revenue from a fee paid by refiners and wholesale distributors to the Department of Revenue along with their monthly distributor tax returns. According to state statute, the board directs the Department of Revenue to impose the fee when the fund's unencumbered balance falls below \$4 million.³ For fiscal years 2009, 2010, 2011, and 2012 (through March 23, 2012), the fee generated annual revenue of \$22,886,587, \$13,088,720, \$13,825,340, and \$27,646,205, respectively.

The board used money from the fund for cleanup-related efforts through the following three departments:

- **Department of Commerce** used money from the fund primarily to reimburse claimants for costs incurred to investigate or cleanup petroleum tank leaks and contamination. While the responsible party⁴ is liable for the cost to remediate the effects of a petroleum tank leak or spill (and the state can enforce this liability through legal civil court action, if necessary),⁵ they can apply for reimbursement from the fund for up to 90 percent of the investigative or cleanup costs.⁶ The department can also reimburse property owners for the removal of abandoned underground petroleum storage tanks newly discovered on the property, regardless of whether a leak had occurred. Those eligible to apply for reimbursement from the

¹ Laws of 1987, Chapter 389 and *Minnesota Statutes* 2011, 115C.

² *Minnesota Statutes* 2011, 115C.07, subd. 1.

³ *Minnesota Statutes* 2011, 115C.08, subd. 2.

⁴ *Minnesota Statutes* 2011, 115C.021 generally defines the responsible party as the owner or operator of the tank at any time during or after the petroleum leak or spill.

⁵ *Minnesota Statutes* 2011, 115C.03, subd. 2.

⁶ *Minnesota Statutes* 2011, 115C.09, subd. 3, limits reimbursements to no more than \$1 million for costs associated with a single release, and not more than \$2 million for costs associated with a single tank facility.

fund included homeowners, businesses, school districts, government agencies, sovereign tribal nations, and petroleum retailers.

Department of Commerce staff also required an applicant to certify that contamination cleanup claims were not and could not be paid through insurance coverage; in some cases, the applicant must submit a letter of denial from their insurance company. Statutes require that if the party responsible for the spill had insurance coverage, the board must pursue recovery of any reimbursements made from the fund.⁷

The Department of Commerce also provided administrative support for the activities of the board and processed the fund's financial transactions.

- **Department of Employment and Economic Development** administered the Contamination Cleanup and Investigation Program. Through this program, it used money from the fund to award grants to assess and clean up contamination to make property available for private and public redevelopment. The department reimbursed grantees for cleanup costs incurred at qualifying sites.
- **Pollution Control Agency** used money from the fund to pay for costs it incurred to clean up (remediate) contaminated sites when there was no identified responsible party or when the responsible party was unable to do the work. These costs included the agency personnel and professional contractor costs to oversee investigations, cleanup, and corrective actions.

The Petroleum Tank Release Compensation Board also adopted rules specifying competitive bidding requirements, maximum cost reimbursement rates, and costs eligible for reimbursement;⁸ heard appeals about reimbursement reductions and inspections; and approved funding requests from the Pollution Control Agency to pay for remediation costs. State statute repeals the legislation that created the oversight board and the fund effective June 30, 2017.⁹

Table 1 summarizes fund expenditures by agency for fiscal years 2009 through 2012.

⁷ *Minnesota Statutes* 2011, 115C.04, subd. 3

⁸ *Minnesota Rules*, chapter 2890.

⁹ *Minnesota Statutes* 2011, 115C.13

Table 1
Petroleum Tank Release Cleanup Fund
Annual Expenditures by Agency
July 1, 2008, through March 31, 2012

<u>Agency</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012¹</u>
Department of Commerce	\$ 9,664,848	\$ 7,546,025	\$ 7,977,938	\$ 5,536,253
Department of Employment and Economic Development	3,517,019	2,000,208	2,593,652	3,982,636
Pollution Control Agency	<u>7,876,525</u>	<u>6,425,300</u>	<u>7,890,946</u>	<u>5,584,413</u>
Total	<u>\$21,058,392</u>	<u>\$15,971,533</u>	<u>\$18,462,536</u>	<u>\$15,103,302</u>

¹ Fiscal year 2012 expenditures are shown through March 31, 2012.

Source: The state's accounting system - Minnesota Accounting and Procurement System (fiscal years 2009-2011) and Statewide Integrated Financial Tools (fiscal year 2012).

The 2010 Legislature authorized transfers totaling \$8,058,000 from the Petroleum Tank Release Cleanup Fund to the state's General Fund to assist in balancing the General Fund shortfall for the 2010-2011 biennium. The Department of Management and Budget transferred \$5 million from the Department of Employment and Economic Development's statutory appropriations for contamination cleanup grants¹⁰ and transferred the remaining \$3,058,000 from the Petroleum Tank Release Cleanup Fund resources available to the Department of Commerce.¹¹

Scope, Objectives, and Methodology

The scope of our audit was to review the expenditures from the Petroleum Tank Release Cleanup Fund made by the Department of Commerce, Department of Employment and Economic Development, and Pollution Control Agency during the period from July 1, 2008, through March 31, 2012.

The objective for our selected-scope audit of the expenditures of the fund was to answer the following questions:

- Did the Department of Commerce, Department of Employment and Economic Development, and Pollution Control Agency have internal controls over the Petroleum Tank Cleanup Fund's financial activities that were adequate to ensure they safeguarded the fund's financial resources, accurately paid claimants and remediation costs in accordance with board and managements' authorizations, complied with finance-related legal provisions, and created reliable financial data?
- Did the entities comply with significant finance-related legal requirements contained in statutes, laws, rules, and agency policies?

¹⁰ *Laws of Minnesota* 2010, ch. 215, art. 7, sec. 3, subd. 6a.

¹¹ *Laws of Minnesota* 2010, ch. 215, art. 4, sec. 3, subd. 5 and sec. 5, subd. 3.

To meet the audit objectives, we gained an understanding of the entities' financial policies and procedures. We considered the risk of errors in the accounting records and potential noncompliance with relevant legal requirements. We analyzed 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 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 various criteria to evaluate internal control and compliance. We used, as our criteria to evaluate agency controls, the guidance contained in the *Internal Control-Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission.¹² We used state laws, as well as policies and procedures established by the departments of Management and Budget and Administration and the agencies' internal policies and procedures as evaluation criteria over compliance.

Conclusion

The Department of Commerce, Department of Employment and Economic Development, and the Pollution Control Agency generally had adequate internal controls over Petroleum Tank Release Clean-up Fund expenditures to ensure that they safeguarded the fund's financial resources, accurately paid claimants and remediation costs in accordance with board and managements' authorizations, complied with finance-related legal requirements contained in statutes, laws, rules, and agency policies, and created reliable financial data.

For the items tested, the entities generally complied with significant finance-related legal requirements.

However, the Department of Employment and Economic Development had some internal control weaknesses and instances of noncompliance.

The following *Finding and Recommendations* provide further explanation about the exceptions noted above.

¹² 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.

Finding and Recommendations

The Department of Employment and Economic Development's contamination cleanup grants did not always comply with some policies.

Finding 1

The department had weaknesses in its monitoring processes and preparation of grant agreements for the Petroleum Tank Release Cleanup Fund.¹³ The department did not follow some requirements of state and department grant policies.¹⁴ In some cases, the department's grant policy had more in-depth requirements than the state policy. The department has weaknesses in the following areas:

- **Lack of onsite visits** - The Department of Employment and Economic Development did not prepare an onsite monitoring plan and did not conduct annual onsite monitoring visits of grantees receiving fund grants totaling \$11.3 million from July 1, 2008, through March 31, 2012.¹⁵ Instead, the department relied on annual progress reports submitted by the grantee to monitor project activities. The onsite visits required by the department's policy could provide more effective oversight and assurance that the grantee complied with the provisions of the grant contract. Without monitoring, the department is less able to effectively assess the progress of grant projects and promptly respond to potential problems.
- **Lack of required grantee financial audits** - The Department of Employment and Economic Development did not require all grantees receiving over \$100,000 annually to submit audited financial statements, as required by department policy.¹⁶ Although the department had developed a centralized process to identify grantees subject to this requirement, that process did not include grantees receiving money from the Petroleum Tank Release Cleanup Fund. As a result, the department was not aware that two of the four grantees we tested had not submitted

¹³ These weaknesses were similar to those we reported in 2010, when we audited other grants administered by the Department of Employment and Economic Development. (Office of the Legislative Auditor, Financial Audit Division Report 10-31, issued September 23, 2010.) In the response to the audit, department staff stated they would update department policies and establish monitoring procedures by June 30, 2011. As of June 2012, the department had not finalized the grant policies changes.

¹⁴ Department of Employment and Economic Development Policy 508.

¹⁵ Department of Employment and Economic Development Policy 508 requires the preparation and execution of an annual monitoring plan that includes at least one annual on-site visit to all grantees with annual dollar volume over \$100,000 and to 25 percent of all grantees with an annual dollar volume between \$10,000 and \$100,000.

¹⁶ Department of Employment and Economic Development Policy 509.

audited financial statements, or that the other two had submitted audit reports because of federal grants received from the department.

- **Lack of closeout monitoring** – The Department of Employment and Economic Development did not conduct timely closeout monitoring for some grants. Department policy describes grant close-out monitoring to include a final financial status report and a reconciliation of cash draws of grant funds to expenses reported. The policy also requires that the close-out of a grant must occur no later than a year after the end of the grant.¹⁷

Although the department had not completed close-out monitoring, it prepared and sent grant adjustment notices to grantees to finalize the grant activity. For example, the department prepared grant adjustment notices for two grants (October 1, 2010, and June 29, 2011) but had not yet performed closeout monitoring at the time of our audit. If close-out monitoring does not occur in a timely manner, it may be more difficult to recover funds that were not spent in compliance with the grant agreement.

- **Deficient Grant Agreements** - The Department of Employment and Economic Development's grant agreements did not contain all the elements required in state and department policy. The grant agreements did not contain workers' compensation provisions and the name and phone number of the agency's project manager, as required by state policy;¹⁸ statements regarding penalties for fraud and abuse; provisions for overpayments and disallowances; grant closeout procedures and requirements; and a statement that the grantee will comply with the Minnesota Human Rights Acts required by department policy.¹⁹ Lack of required language in a grant agreement may cause the grantee to be unaware of the requirement or could make the requirement difficult to enforce.

In addition, some scanned grant payment documents were blurry or unavailable for five of the ten grants we tested. The department was able to locate original paper documents that had not yet been destroyed for three of the grants and obtained documentation directly from one grantee; however, the department was unable to provide documentation to support one of these grants. The lack of quality electronic filing and scanning practices increases the risk that evidence will not be available to support payments and could increase the ability for fraudulent transactions to occur without detection.

¹⁷ Department of Employment and Economic Development Policy 508.

¹⁸ Department of Administration, Office of Grants Management Policy 08-04.

¹⁹ Department of Employment and Economic Development Policy 508.

Recommendations

- *The Department of Employment and Economic Development should comply with state and department grant policies by:*
 - *conducting site visits,*
 - *requesting and reviewing financial statement audit reports,*
 - *conducting timely closeout monitoring, and*
 - *ensuring that grant agreements include all the required elements.*
 - *The Department of Employment and Economic Development should develop quality control procedures to ensure that scanned grant documents are available and readable.*
-

October 25, 2012

Mr. James R. Nobles
Legislative Auditor
State of Minnesota
First Floor, Centennial Building
658 Cedar Street
St. Paul, MN 55155

Dear Mr. Nobles:

Thank you for the opportunity to respond to the finding and recommendations for the Department of Employment and Economic Development (DEED) related to the audit of the Petroleum Tank Release Cleanup Fund for the period from July 1, 2008 through March 31, 2012.

Audit Finding: The Department of Employment and Economic Development's contamination cleanup grants did not always comply with some policies.

Recommendations:

- *The Department of Employment and Economic Development should comply with state and department grant policies by:*
 - *conducting site visits,*
 - *requesting and reviewing financial statement audit reports,*
 - *conducting timely closeout monitoring, and*
 - *ensuring that grant agreements include all required elements.*
- *The Department of Employment and Economic Development should develop quality control procedures to ensure that scanned documents are available and readable.*

Response: The department agrees with the finding and recommendations. DEED's policy regarding financial statement audits was updated in August of 2012 to comply with state statutes and Office of Grants Management (OGM) policy. DEED's policy regarding grant monitoring is in the process of being updated to comply with OGM policy. Policy and procedure updates had been delayed due to the implementation of the state's new SWIFT financial system in July of 2011.

DEED performed closeout monitoring for all grants, but some were not completed within one year. DEED believes that the monitoring procedures performed provided reasonable assurance that the conditions of each grant agreement was upheld. Staff maintained regular communications with each grantee and detailed invoices were reviewed prior to authorization for payment.

DEED is currently in the process of reviewing all grant agreement templates to ensure that they comply with OGM policy. These templates will be loaded into the SWIFT system and be used for new grant agreements beginning in January of 2013.

DEED will ensure that legible grant documents are properly stored in the imaging system. The original paper documents obtained by DEED indicated that payment requests were reasonable, necessary, and fulfilled the terms of each grant agreement. DEED will review scanned documents that are important for audit purposes to ensure that they are legible prior to destruction of the paper document. This change will be implemented immediately.

Cindy Farrell, Chief Financial Officer, will oversee the resolution of this finding by December 31, 2012.

If you have any questions or need additional information, please contact Cindy Farrell at 651-259-7085 or Cindy.Farrell@state.mn.us.

My best regards,

A handwritten signature in black ink, appearing to read 'K. Clark', with a stylized flourish at the end.

Katie Clark
Commissioner