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OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Financial Audit Division Report

Office of Environmental Assistance
July 1, 2001, through June 30, 2004



MAY 12, 2005

05-27

Financial Audit Division

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

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

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

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

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

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

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Senator Ann H. Rest, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Art Dunn, Director
Minnesota Office of Environmental Assistance

We have audited the Office of Environmental Assistance (OEA) for the period July 1, 2001, through June 30, 2004. Our audit scope included grants and loans, payroll and administrative expenditures, and pollution prevention fees. Our audit objectives addressed OEA's internal controls over financial operations and compliance with significant financial-related legal provisions.

The Report Summary highlights our overall audit conclusions. The specific audit objectives and conclusions are contained in the individual chapters of this report.

We would like to thank OEA staff for their cooperation during the audit.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: March 11, 2005

Report Signed On: May 9, 2005

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Audit Participation

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

Claudia Gudvangen, CPA	Deputy Legislative Auditor
Jim Riebe, CPA	Audit Manager
Carl Otto, CPA	Auditor-in-Charge
George Deden, CPA	Senior Auditor
Laurinda Zavala	Auditor

Exit Conference

We discussed the results of the audit with the following staff of the Office of Environmental Assistance at an exit conference on April 22, 2005:

Art Dunn	Director
David Benke	Strategic Directions Manager
Bill Sierks	Strategic Operations Manager

Report Summary

Conclusion:

The Office of Environmental Assistance's (OEA) accounting procedures helped ensure that its financial transactions were accurately recorded in the accounting records and complied with management's authorization. However, we identified the following concerns.

Key Findings:

- OEA did not consistently comply with state and internal purchasing guidelines. (Finding 1, page 8)
- OEA administers an employee recognition program that does not comply with state guidelines and may have resulted in unreported income to employees. (Finding 3, page 9)
- OEA did not document important monitoring activities for some competitive grants. (Finding 4, page 12)
- OEA has not yet billed companies for certain pollution prevention fees due in fiscal year 2005 because the Department of Public Safety did not provide required billing information. (Finding 5, page 15)

The report contained five findings related to internal control and legal compliance. OEA resolved one prior audit finding related to controls over pollution prevention fees.

Audit Scope:

Audit Period:

July 1, 2001, to June 30, 2004

Programs Audited:

- Grants and Loans
- Payroll and Administrative Expenditures
- Pollution Prevention Fees

Agency Background:

OEA's mission is to protect Minnesota's environment through waste prevention and resource conservation. OEA is a nonregulatory agency that works to improve the environment through partnerships, technology transfer, technical assistance, education, research, and matching grants.

OEA received an appropriation of about \$23.4 million in fiscal year 2004. It spent about \$5.3 million on payroll and administrative expenditures and about \$17.7 million on environmental assistance grants.

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Chapter 1. Introduction

The Office of the Legislative Auditor selected the Office of Environmental Assistance (OEA) for audit based on an annual assessment of state agencies and programs. We used various criteria to determine the entities to audit, including the size and type of each agency's financial operations, length of time since the last audit, changes in organizational structure and key personnel, and available audit resources. It had been four years since our last audit of OEA.

Agency Overview

The mission of OEA is to protect Minnesota's environment through waste prevention and resource conservation. The Minnesota Waste Management Act (*Minnesota Statutes 115A*) governs the agency's activities. The OEA provides technical and financial assistance to local governments, businesses, non-profit organizations, and citizens to reduce pollution and manage waste. The activities of the OEA are financed mainly by legislative appropriations.

Art Dunn is the director of OEA. The commissioner of the Pollution Control Agency appoints the director. OEA had 62 employees as of December 2004. OEA's main office is located in St. Paul. OEA also has regional offices located in Bemidji, Brainerd, Detroit Lakes, Duluth, Marshall, and Rochester.

Table 1-1 summarizes OEA's financial activity during fiscal years 2002 through 2004. In addition to the dedicated revenues presented in the table that OEA has the authority to spend, it also collects nondedicated revenue that it does not have the authority to spend. Pollution prevention fees represent the largest nondedicated receipt. These fees are deposited in the state treasury and credited to the Environmental Fund. Pollution prevention fees, which totaled approximately \$3.8 million during the audit period, are discussed in Chapter 4.

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**Table 1-1
Sources and Uses of Funds
By Fiscal Year**

	<u>2002</u>	<u>2003</u>	<u>2004</u>
Sources:			
Appropriations ⁽¹⁾	\$28,338,784	\$25,019,860	\$23,425,574
Dedicated Revenues ⁽²⁾	593,386	218,097	262,526
Balances Forwarded In	396,592	2,323,884	611,187
Transfers In ⁽³⁾	<u>2,984,695</u>	<u>3,189,038</u>	<u>2,370,186</u>
Total Sources	<u>\$32,313,457</u>	<u>\$30,750,879</u>	<u>\$26,669,473</u>
Uses:			
Expenditures:			
Grants	\$24,565,921	\$23,766,057	\$17,659,311
Payroll	3,832,904	4,253,767	4,257,874
Rent	288,357	373,674	289,986
Equipment and Supplies	154,651	238,381	121,385
Loans	0	100,000	100,000
Travel	142,501	107,006	82,784
Professional/Technical Services	253,240	168,622	165,999
Other Expenses and	<u>457,123</u>	<u>434,868</u>	<u>511,858</u>
Encumbrances			
Subtotal Expenditures	\$29,694,697	\$29,442,375	\$23,189,197
Other Uses:			
Transfers Out	294,876	697,317	323,674
Balance Forwarded Out	<u>2,323,884</u>	<u>611,187</u>	<u>3,156,602</u>
Total Expenditures and Other Uses	<u>\$32,313,457</u>	<u>\$30,750,879</u>	<u>\$26,669,473</u>

(1) Appropriation balance is reported net of cancellations and budget reductions.

(2) Dedicated revenues, which the department has the authority to spend, include federal grants, interest earnings, donations, and seminar and workshop fees. Federal grant and donations declined during the audit.

(3) The majority of the transfers-in are for receipts collected by the Department of Revenue for metro solid waste landfill fees.

Source: Minnesota Accounting and Procurement System's data through September 30, 2004.

Audit Approach

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

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

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Chapter 2. Payroll and Other Administrative Expenditures

Chapter Conclusions

OEA's controls helped ensure that it properly compensated staff and accurately paid vendors. Payments were recorded accurately in the accounting records and made in accordance with management's authorization. However, the agency did not consistently comply with state and internal purchasing guidelines. In addition, the agency did not effectively monitor system security clearances of its employees. Also, the agency administers an employee recognition program that does not comply with state guidelines and may have resulted in unreported income to employees.

Audit Objectives

We focused our review of administrative expenditures on the following objectives:

- Did OEA's controls provide reasonable assurance that it accurately compensated staff and paid vendors for goods and services received and properly recorded payroll and operating expenditures in the state's accounting system?
- For the items tested, did OEA comply with significant finance-related legal provisions, compensation plans, and management's authorization?

Background

OEA's payroll and administrative expenditures averaged about \$5.3 million annually for fiscal years 2002 to 2004. As shown in Table 1-1, payroll expenditures are the largest operating cost accounting for 78 percent of the annual spending budget, or averaging about \$4.1 million annually. The agency employed approximately 62 individuals as of December 2004. Rent and other operating costs, such as equipment, supplies, travel, and professional and technical services, account for the remaining 22 percent. OEA averaged \$317,000 each year for office space rent from fiscal years 2002 through 2004. OEA rents space from the Minnesota Pollution Control Agency in St. Paul and also at several regional locations.

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Current Findings and Recommendations

1. The agency did not consistently comply with state and internal purchasing guidelines.

OEA did not consistently comply with state and internal purchasing guidelines, including purchasing card guidelines, or provide adequate supporting documentation for certain purchases. The Department of Administration establishes purchasing policies and procedures that state agencies are required to follow. These policies govern competitive bidding requirements that vary depending on the dollar amount of the purchase, the use of purchasing cards, etc. OEA has developed additional internal purchasing procedures that are more restrictive in some cases, particularly regarding purchasing card limits. We noted the following concerns with OEA purchases.

OEA did not consistently provide documentation that supported the advance authorization for the purchase. We noted the following exceptions based on 30 administrative expenditure transactions we tested. Four transactions did not have authorized purchase orders on file to support the payment. Four other transactions did not have an authorized request to incur special expense to support the special expense payment.

In addition, OEA did not comply with state and internal purchasing guidelines in some cases, including purchasing card guidelines. The agency purchased display boards for \$7,489 and postage stamps for \$4,873 that exceeded the \$2,500 maximum amount allowed for purchasing card transactions according to the Department of Administration's requirements. The display boards purchase also exceeded OEA's \$5,000 level of authority for local purchasing. Therefore, that purchase should have been processed by the Department of Administration. Administration would have prepared a public notification of the intent to purchase the display boards and would have obtained three written competitive bids for the purchase. Neither of these requirements were met. Of the transactions we tested, OEA made six purchases using the state-purchasing card that exceeded the \$500 maximum amount allowed per transaction according to its internal purchasing card guideline. By not following applicable purchasing guidelines, the risk of unauthorized purchases and the risk of not paying competitive prices increases.

Recommendation

- *OEA should revise its operating procedures to ensure compliance with state purchasing policies. It should either comply with its internal purchasing card guidelines or determine whether its more restrictive purchasing card transaction limit is justified.*

2. OEA did not adequately monitor computer system security reports and modify employee access based on current job duties.

OEA did not adequately monitor computer access to its payroll/personnel system or its accounting system. OEA granted incompatible access to an employee who could both process

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purchase orders and make payments in the accounting system. Normally these duties are performed by different individuals to strengthen control over the accounting cycle. Some OEA employees had system access they no longer needed after OEA contracted with the Minnesota Pollution Control Agency, in April 2004, to process disbursements and personnel and payroll transactions. Therefore, the system access of these employees should have been removed.

The risk of errors or inappropriate payments increases when employees have system access that is not necessary to fulfill their job responsibilities. System access also needs to be monitored when new employees are hired, employees resign, or employees take on new responsibilities within the department.

Recommendation

- *OEA should periodically monitor employee access to ensure clearance is limited to current job responsibilities. The department should ensure it considers incompatible duties when granting system access to employees and develop other controls if necessary to detect possible errors or irregularities.*

3. OEA administers an employee recognition program that does not comply with state guidelines and may have resulted in unreported income to employees.

OEA established an employee recognition program approximately five years ago. OEA established internal policies and procedures for their recognition program. Under the program, OEA gives employees gift cards to local businesses in amounts from \$10 to \$250. There are both team and individual awards. Employees may receive more than one award per year. During the audit period, OEA spent approximately \$16,000 in FY2002, and \$21,000 in FY2003. OEA postponed the awards in fiscal year 2004 because of budget constraints.

OEA staff stated that they based the recognition program and awards on employee bargaining agreements. These agreements provide the authority for achievement awards and other employee incentive plans. The plans give the appointing authority some discretion in how the incentive programs are administered. However, achievement awards and other incentives authorized in the bargaining unit agreements are to be monetary and processed through the state's payroll system in order to be included in employee income calculations. OEA did not report these awards as taxable income to the employees. According to Internal Revenue Service Publication 525, titled "Taxable and Nontaxable Income," "If your employer gives you cash, a gift certificate, or a similar item that you can easily exchange for cash, you include the value of that kind of gift as extra salary or wages regardless of the amount involved."

Recommendation

- *OEA should work with the departments of Finance and Employee Relations to ensure that their incentive plan is administered in accordance with employee contracts and that income from the incentive programs is properly reported to the employee.*

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Chapter 3. Grants and Loans

Chapter Conclusions

OEA's controls provided reasonable assurance that it appropriately awarded grants and loans to eligible recipients and that it properly recorded grant and loan expenditures on the state's accounting system. However, the agency did not always effectively document its monitoring of some competitive grants.

Grant expenditures and loan activity complied with significant finance-related legal provisions for the items tested, except that documentation supporting grantee equipment purchases was not always on file, as required by the terms of the grant agreements.

Audit Objectives

Our audit of grant and loan expenditures focused on the following questions:

- Did OEA's controls provide reasonable assurance that it appropriately awarded and monitored grants and loans to eligible recipients and accurately recorded the financial activity in the state's accounting system?
- For the items tested, did OEA comply with significant finance-related legal provisions and management's authorization?

Background

The largest category of expenditures at OEA is for grant payments to local units of government, businesses, and nonprofit organizations. The agency disbursed most grant funds for county waste reduction and recycling projects under the Governor's Select Committee on Recycling and the Environment (SCORE) grants. In addition, OEA makes grants to metropolitan counties from revenue received from the Metropolitan Landfill Abatement Account. The agency also awarded various other grants for the development of markets for recyclables and problem waste; the prevention, separation, and collection of waste; capital assistance; and grants that provide educational, technical, and research assistance to the public.

As authorized by legislation enacted in 2001 and amended in 2003, OEA can award loans for any of the purposes applicable to grants, as mentioned above. OEA issued three new loans during the scope of our audit. These loans bear no interest; repayment of their principal is due in ten equal installments over the ten-year period following the inception of each loan. Commercial banks participate in extending additional credit to the entities receiving funds. Principal

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repayments may be used in the future to award other loans on a revolving basis. Loan repayments during the audit scope ranged from \$42,000 to \$79,000 per year.

During the same period, OEA wrote off the balances of two uncollectible loans. After seizing the state's security interest of \$96,000, and an additional \$78,000 that is currently in an escrow account awaiting final determination, the net amount of the write-off totaled \$809,000. The loans written off were originally made in the early 1990s as part of a different loan program that OEA administered at that time. Based on agency records, there were 13 loans awarded during that period of time, for a total of approximately \$3.1 million. Many of these loans were made to start-up companies, engaging in new technologies related to recycling and waste reduction.

Table 3-1 shows grant and loan disbursements by type.

	<u>2002</u>	<u>2003</u>	<u>2004</u>
SCORE Grants ⁽¹⁾	\$14,008,000	\$11,150,200	\$12,500,000
Business Assistance Grants	621,935	619,730	657,025
Solid Waste Processing Credit	6,000,000	7,391,270	3,999,943
Capital Assistance Grants	1,150,000	0	0
Metro Landfill Grants	2,380,148	2,559,514	(2)
Competitive Grants	406,593	2,044,589	502,343
Loans	0	100,000	100,000
Total	<u>\$24,566,676</u>	<u>\$23,865,303</u>	<u>\$17,759,311</u>

(1) The funds available for these grants were reduced as a result of legislative action for the 2003-2004 biennium.

(2) OEA issued FY2004 Metro Landfill Grants totaling \$1,767,047 in November 2004 and coded them to FY2005.

Source: Minnesota Accounting and Procurement System (MAPS) expenditures as of September 30, 2004.

Current Finding and Recommendation

4. OEA did not document important monitoring activities for some competitive grants.

OEA needs to strengthen certain controls over its competitive grants to address a number of weaknesses associated with its grant administration practices. We observed that the documentation practices for the grant activity were largely inconsistent and varied widely among recipients and grant managers. Specifically:

- The agency did not always document grant monitoring activities. The details of communications with grantee personnel, site visits, and inspections were often not documented. The grant files did not contain evidence that recipients provided OEA with the monthly oral reports required by grant agreements.
- Grantees did not always submit invoices for grant-covered costs in cases where a given nonpayroll category exceeded \$500, as required by the grant agreement. In certain cases,

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alternative types of documentation were on file, while other times the files did not contain documentation to support these costs.

- The available evidence for the grants we tested suggests that there was only sporadic use of relevant checklists designed for purposes of documenting the awarding of grants and the processing of outlays to the grantee organizations.

Appropriate documentation is necessary to ensure that both the agency and the grantee organizations are in compliance with the requirements of the grant agreements. In addition, inconsistent practices hinder the ability of management and outside parties to evaluate the operational efficiency and programmatic effectiveness of the agency grants.

Since mid-2004, as a result of an internal management review, OEA has revised its grant administration policies and procedures. Agency personnel have taken a comprehensive and long-term approach to address the weaknesses identified above and expect significant improvements for new grants.

Recommendation

- *OEA should continue its efforts to standardize grant administration processes and should develop stronger controls in documenting grant-related activities for its competitive grants.*

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Chapter 4. Pollution Prevention Fee Revenue

Chapter Conclusions

OEA's controls helped ensure that it appropriately billed for pollution prevention fees and properly collected, deposited, and recorded these receipts in the accounting records during the audit period. However, OEA has not been able to invoice businesses for pollution prevention fees in fiscal year 2005 because the Department of Public Safety has not provided required billing information. For the transactions tested, OEA administered receipts in compliance with applicable legal provisions.

Objective

We focused our review of receipts on the following objective:

- Did OEA's internal controls ensure it billed for pollution prevention fees, monitored unpaid balances due, and accurately recorded fees in the accounting records?
- Did OEA adequately safeguard receipts and administer receipts in compliance with applicable legal provisions?

Background

OEA invoices and collects two types of pollution prevention fees. The majority of the fees are based on toxic chemical releases reported by facilities to the Department of Public Safety. The pollution prevention fees support Minnesota's pollution prevention assistance activities. The fees are deposited as nondedicated revenue, which OEA does not have authority to spend, in the Environmental Fund. Pollution prevention fees totaled about \$1.3 million each of the past three fiscal years.

Current Finding and Recommendation

5. OEA has not billed companies for certain pollution prevention fees because the Department of Public Safety did not provide the required information.

OEA has been unable to bill the main portion of fiscal year 2005 pollution prevention fees because the Department of Public Safety has not furnished the data as required by statute. *Minnesota Statutes* 115D.12, Subd. 2, requires that the fees be paid to OEA by January 1 of each year. The Federal Emergency Planning and Community Right-to-Know Act requires certain facilities to report releases of listed toxic chemicals to the Emergency Planning and Community

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Right to Know Program in the Division of Homeland Security and Emergency Management of the Minnesota Department of Public Safety. The data collected by the Department of Public Safety is provided to the OEA to assess the fees. According to the Department of Public Safety, it has not been able to provide the information because of problems encountered in updating its computer database. OEA has notified businesses that the billing will be assessed as soon as the data is available.

Recommendation

- *OEA should continue to work with the Department of Public Safety to obtain the necessary information to invoice the remaining pollution prevention fees.*

**Status of Prior Audit Issues
As of March 11, 2005**

May 2000, Legislative Audit Report 00-15 covered the three years ended June 30, 1999. The scope of the audit included revenues, grants, loans, and administrative expenditures. The report contained one finding related to controls over pollution prevention fees collected by the Department of Public Safety. OEA now collects these fees and has resolved the finding.

State of Minnesota Audit Follow-Up Process

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

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April 28, 2005

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

Dear Mr. Nobles:

The Office of Environmental Assistance (OEA) greatly appreciates the opportunity to discuss with you and your staff the findings of your review of OEA's operating procedures. We concur with the findings of the audit and the following responses address specific findings and recommendations mentioned in your report.

1. Finding: "The agency did not consistently comply with state and internal purchasing guidelines."

Recommendation: *"OEA should revise its operating procedures to ensure compliance with state purchasing policies. It should either comply with its internal purchasing card guidelines or determine whether its more restrictive purchasing card transaction limit is justified."*

Response: OEA purchasing staff will retain the more restrictive purchasing card limit and consult with Department of Administration staff when necessary. This consultation will be documented and retained. In the future, if this procedure is not practical, OEA will revisit the need to increase the purchasing card limit.

A statement will be added to OEA's purchasing procedures explaining that all supporting documentation must be attached to every invoice and that all conversations with Department of Administration staff must be documented and retained.

2. Finding: “OEA did not adequately monitor computer system security reports and modify employee access based on current job duties.”

Recommendation: *“OEA should periodically monitor employee access to ensure clearance is limited to current job responsibilities. The department should ensure it considers incompatible duties when granting system access to employees and develop other controls if necessary to detect possible errors or irregularities.”*

Response: OEA has transferred security clearance duties to a staff member more closely aligned with the duties so that oversight responsibilities are maintained. This person will work with the PCA to maintain appropriate security clearances.

3. Finding: “OEA administers an employee recognition program that does not comply with state guidelines and may result in unreported income to employees.”

Recommendation: *“OEA should work the departments of Finance and Employee Relations to ensure that their incentive plan is administered in accordance with employee contracts and that income from the incentive programs is properly reported to the employee.”*

Response: When originally establishing this recognition program as an alternative to achievement awards, the OEA did consult with the Department of Employee Relations. DOER did not mention any conflict with taxation laws at the time, but OEA will consult again with them and with the Department of Finance in order to resolve the findings of this audit.

4. Finding: “OEA did not document important monitoring activities for competitive grants.”

Recommendation: *“OEA should continue its efforts to standardize grant administration processes and should develop stronger controls in documenting grant-related activities for its competitive grants.”*

Response: As indicated in this report, OEA has developed a Six Sigma process to address grant documentation, control and effectiveness. We anticipate that the implementation phase of this process will be complete by August of 2005, and we will then begin the monitoring phase in order to assure continued success of the project.

5. Finding: “OEA has not billed companies for certain pollution prevention fees because the Department of Public Safety did not provide the required information.”

Recommendation: *“OEA should continue to work with the Department of Public Safety to obtain the necessary information to invoice the remaining pollution prevention fees.”*

Response: This billing issue addresses only bills that were due to be mailed in December of 2004 and the issue resulted from a computer problem at the Minnesota Department of Public Safety. OEA has worked with DPS officials to address the problem and on April 19, 2005 the necessary data was received by OEA and the billing process is proceeding.

The OEA managers given responsibility for taking the necessary corrective actions and to assure compliance are:

David Benke, Strategic Directions Manager
651-215-0196
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Bill Sierks, Strategic Operations Manager
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Again, thank you for the assistance your audit team has provided the OEA, and we look forward to using the information provided to improve our operations.

Sincerely,

/s/ Art Dunn

Art Dunn
Director