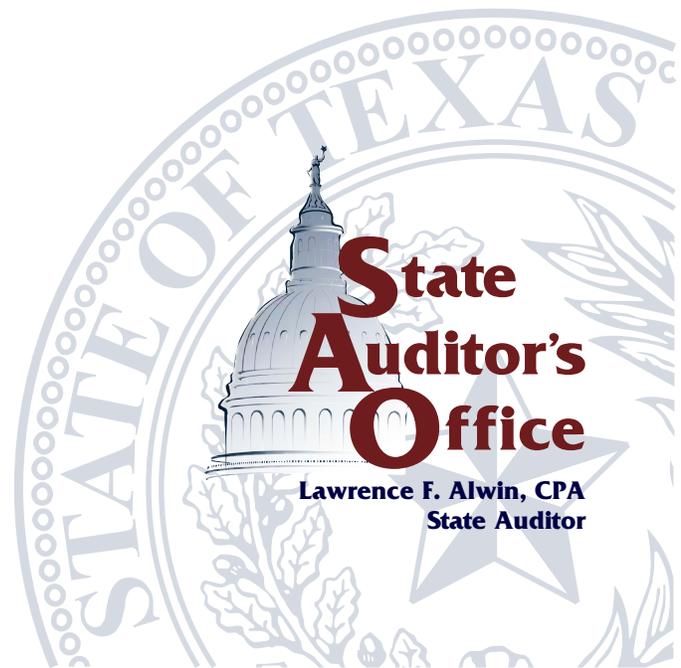


An Audit Report on

The Texas State Soil and Water Conservation Board

March 2004

Report No. 04-023



The Texas State Soil and Water Conservation Board

Overall Conclusion

The Texas State Soil and Water Conservation Board's (Board) past financial reports have not consistently been reliable, in part because the Board has lacked basic written procedures for budgeting and accounting. The Board has met reporting requirements specific to itself, but it has not submitted several key reports required from all state agencies. Some of the reports it did submit contained some deficiencies. For example, the Board's Legislative Appropriations Request did not accurately project future expenditures.

While there are opportunities for the Board to improve its oversight controls of expenditures made or approved by the local soil and water districts, it generally safeguards the physical, cash, and information technology assets held at the central office. The Board's largest expenditures are for cost-share projects implemented by private landowners, such as for brush control. Local districts approve the payments for these projects. The Board needs to strengthen its guidance and oversight of such pass-through expenditures. For example, the Board allows landowners to contract with themselves and related parties. Because this audit focused on the Board's administrative functions and budget, we cannot provide assurance that district-level controls are in place and working effectively. However, we are currently following up on several questionable transactions approved by districts.

The Board was appropriated \$538,265 for its indirect administration strategy for each year of the 2002-2003 biennium. The Board's actual administrative expenditures for these years exceeded its appropriations by 16 percent and 5 percent, respectively. These overages were within the Board's authority to transfer funds across strategies, and the transfers from other strategies did not exceed 25 percent.

The Board also lacks procedures for reporting on its performance. It reports that it meets most of its performance measures; however, our most recent audit of the Board's performance measures could not certify the measures as accurate. This audit confirmed that the Board lacks sufficient procedures and definitions to ensure accurate, consistent performance reporting and progress toward its goals and objectives.

With the exception of not submitting some required reports (as discussed above), the Board complies with key requirements from the Government Code (such as Open Meetings), the Agriculture Code, and the General Appropriations Act. The Board has implemented management recommendations from the Texas Sunset Advisory Commission. However, the

About the Texas State Soil and Water Conservation Board

The mission of the Soil and Water Conservation Board is to administer the state's soil and water conservation law, coordinate the programs of soil and water conservation districts, and guide the abatement of agricultural and silvicultural nonpoint source pollution.

The weaknesses noted in this report existed before the Board experienced significant changes in the summer of 2003. Specifically, the Board has experienced a reduction in budget; a nearly 50 percent reduction in staffing at its central office; and turnover and reassignments of employees, executive management, and governing board members. We credit management for its positive attitude toward internal controls and the strong contracted internal audit function. We appreciate the cooperation of Board staff throughout the audit.



Board has not maintained a complaint file as required by Section 201.0231 of the Agriculture Code.

In fiscal year 2003, the Board's expenditures to local conservation districts totaled \$3.5 million, and payments to landowners for cost-share programs (such as for brush control) totaled \$13.8 million.

Summary of Information Technology Review

The Board has made progress in implementing recommendations to address control weaknesses identified during an internal audit of the information technology (IT) function, including compliance with statutory and Department of Information Resources requirements; controls, security, and procedures; and processes and procedures for meeting needs of users.

The Board's IT staff is to be commended on the overall security of the network. Our testing of network vulnerabilities revealed strengths with the Board's wireless system and external network security. However, we identified minor weaknesses with its internal network security. The Board should use the vulnerability reports we provided to address these weaknesses.

Objectives, Scope, and Methodology

This audit was conducted to meet the requirements of Senate Bill 1828, which stated that:

"Not later than March 1, 2004, the state auditor, in coordination with the Legislative Budget Board, shall conduct a management audit of the State Soil and Water Conservation Board and deliver the audit report to the governor, the lieutenant governor, and the speaker of the house of representatives. The audit report must include an evaluation of the administrative budget for the board."

Accordingly, we coordinated with the Legislative Budget Board throughout the audit, and we have appreciated its advice and assistance. We focused almost exclusively on the administrative functions and budget of the Board's central office in Temple, Texas. Chapter 3 provides summary data on the Board's budget and expenditures, including expenditures for indirect administration.

The objectives for this audit were to determine whether the Board:

- Maintains and reports reliable financial and program data.
- Safeguards its assets and uses them efficiently.
- Makes progress toward its goals and objectives.
- Complies with applicable laws and regulations.

This audit focused primarily on conditions and transactions from fiscal years 2000 through 2003; however, we also took into account newer information as it became available. We conducted this audit in accordance with generally accepted government auditing standards applicable to performance audits.

In addition to sampling and testing financial transactions, our audit methodology included extensive use of analytical procedures, reliance on internal audit findings and recommendations, network scanning, and review of relevant documents such as the Board's enabling legislation and riders from the General Appropriations Act.

Detailed Results

Chapter 1

Does the Board maintain and report reliable information?

The Texas State Soil and Water Conservation Board's (Board) past financial reports have not consistently been reliable, in part because the Board has lacked basic written procedures for budgeting and accounting. The Board has met reporting requirements specific to itself, but it has not submitted several key reports required from all state agencies. Some of the reports it did submit contained some deficiencies. For example, the Board's Legislative Appropriations Request did not accurately project future expenditures. In our limited review of the Board's Annual Financial Report (AFR) for fiscal year 2003, nothing came to our attention to indicate that the financial statements are materially misstated. However, the AFR did not disclose the Board's close relationship with the Association of Soil and Water Conservation Districts (Association).

Chapter 1-A

The Board Lacks Basic Budgeting and Accounting Procedures

The lack of basic procedures for budgeting and accounting and other control weaknesses affect the Board's ability to maintain and report reliable information.

Until recently, the Board did not reconcile the Uniform Statewide Accounting System (USAS) to its internal subsystems. The Board began reconciling USAS to its internal subsystems recently in response to an internal audit recommendation. However, the reconciliations are not sufficiently documented.

Recommendation

The Board should develop comprehensive, detailed, written procedures for budgeting and accounting. The procedures should address documentation of the reconciliations between internal ledgers and USAS and internal control weaknesses identified by the internal auditor and by this audit. We understand that an initiative is partly underway to develop such procedures.

Management's Response

Management concurs. A lack of comprehensive and detailed written procedures was identified as an internal weakness in August 2003. Since, the Fiscal Officer has started developing comprehensive and detailed written procedures for all agency budgeting and accounting functions. Anticipated completion date for these procedures is August 2004.

The Board's Compliance with Reporting Requirements Is Inconsistent

The Board submits reports related to the programs it administers on time and with the required information. However, it did not submit some key required reports or did not submit them in a timely manner:

- Reconciliations of USAS to the Automated Budget and Evaluation System of Texas (ABEST) were not submitted for the first three quarters of fiscal year 2003. The Board hired a contractor to submit the fourth-quarter reconciliation. The Legislative Budget Board uses the ABEST-USAS reconciliation to ensure that expenditures align with the Board's appropriation structure.
- Quarterly federal funds activity reports have not consistently been submitted to the Governor's Office, although the Board submitted the report for the first quarter of fiscal year 2004. The Governor's Office uses these reports to manage federal funding for state government.
- Fleet management policies and procedures have not been submitted to the Texas Building and Procurement Commission (TBPC). The TBPC reviews these to ensure that state agencies' fleet management policies and procedures are consistent with the overall state fleet management objectives.

Other submitted reports contained some deficiencies. Specifically:

- In the Board's Legislative Appropriations Request (LAR), we found significant variances between the amounts requested/received and actual expenditures. Because the Board has authority to carry forward unexpended balances, the Board spent \$9.0 million more in fiscal year 2003 than it estimated in its LAR and \$13.4 million more than was included in its bill pattern.
- The Board's strategic plan is not comprehensive in describing the implementation of its strategies. It also does not comply with the instructions of the Governor's Office of Budget and Planning and the Legislative Budget Board in providing information such as a historically underutilized business assessment and a description of the Board's planning process.

Recommendations

To ensure that it consistently complies with reporting requirements, the Board should:

- Track what reports are due and when to ensure that it meets all applicable reporting requirements. During this audit, we provided the Board with an administrative calendar from another state agency that the Board can modify to meet its needs. The Board appears to have already implemented the calendar.
- Integrate, in more descriptive and measurable terms, the information contained in its strategic plan and LAR.

Management's Response

Management concurs with recommendation. All reports have been brought current. A master administrative calendar was developed in January 2004 to better track when reports are due and ensure all applicable reporting requirements are met. Management will continue working closely with the Office of the Governor, the Comptroller of Public Accounts, and the Legislative Budget Board to revise and update the agency's strategic plan, legislative appropriation request, and operating budget.

Chapter 1-C

The Board Should Disclose Its Relationship with the Association of Soil and Water Conservation Districts

In our limited review of the Board's AFR for fiscal year 2003, nothing came to our attention to indicate that the financial statements are materially misstated. However, the AFR did not disclose the Board's close relationship with the Association of Soil and Water Conservation Districts (Association). Disclosure would help readers of the AFR fully understand the Board's operations and would be consistent with the intention behind Note 14, Related Parties. The Board should disclose the relationship for the following reasons:

- The organizations occupy contiguous leased space in the same building and share other common resources.
- As a chartered nonprofit corporation, the Association can engage in activities, such as lobbying and fundraising, prohibited to the Board.
- Districts pay dues to the Association.
- Members of the governing boards for both the Board and the Association are drawn from the same pool of local district directors, and the organizations jointly host the annual meeting of district directors.
- The organizations have signed a memorandum of understanding that obligates each to the other.

Recommendation

The Board should disclose its relationship with the Association in its AFR.

Management's Response

Management concurs. The agency will disclose all relationships with the Association of Soil and Water Conservation Districts in future Annual Financial Reports.

Does the Board safeguard its assets?

The Board needs to strengthen its oversight of expenditures made or approved by the local districts. Most of these controls reside with the local soil and water districts, which were not included in our planned audit objectives. We noted opportunities for the Board to improve its oversight of these expenditures. However, the Board generally safeguards its physical, cash, and information technology assets held by its central office. In fiscal year 2003, the Board's expenditures for indirect administration totaled \$564,941, expenditures to local conservation districts totaled \$3.5 million, and expenditures to landowners for cost-share programs (such as for brush control) totaled \$13.8 million.

Chapter 2-A

The Board's Oversight of Pass-Through Expenditures Needs Improvement

The Board's oversight of payments either made or approved by local districts is limited; thus, the Board can provide only limited assurance that districts have spent or approved the funds as the Legislature intended.

Payments to landowners. The Board's largest expenditures are to landowners via cost-share programs such as the Brush Control program. For these programs, the primary controls are at the district level. The controls include selecting projects, setting the cost-share percentage, certifying that the work has been completed, and approving the payments. By design, the Board merely ensures the administrative completeness of the district approvals. Our testing of brush control contracts found nothing to indicate that the Board had questioned the payments once the payments had received district approval.

We identified the following issues of concern:

- The Board reimburses participating landowners based on the amount that the vendor performing the work invoices rather than on the amount the landowner pays the vendor. This situation allows for possible collusion between the landowner and the vendor to invoice for an amount greater than the actual payment.
- The Board allows landowners to contract with themselves and related parties. We identified a landowner who was reimbursed \$122,180 in state funds for hiring his bulldozing company to bulldoze his land. We identified another transaction in which an employee of a subcontractor authorized \$9,248 in payments to companies operated by her husband and son.
- It is common for local district directors to have cost-share contracts. The Board requires disclosure when a local district director applies for and receives cost-share assistance, and, at local board meetings, the district director is prohibited from voting on projects in which he or she has a financial interest. However, the Board does not have a central control to ensure compliance with this requirement.

We are currently following up on several questionable transactions approved by districts; if we find indications of fraud, we will refer them to our Special Investigations Unit for further investigation and disposition.

The Board's Manual of Fiscal Operations provides guidance to districts on matters of internal control, but the Board has not yet developed a more specific procedure for local districts on how to identify and address potential instances of fraud. In late calendar year 2003, a State Auditor's Office investigation found that a bookkeeper for a local soil and water conservation district had committed payroll fraud (*A Special Investigations Unit Report Regarding the Texas State Soil and Water Conservation Board*, SAO Report No. 04-013, November 2003).

Payments to districts. The General Appropriations Act for the 2004–2005 biennium does not give local soil and water conservation districts explicit authority to carry forward balances of state funds across biennia. Without this authority, the unexpended state funds should lapse to the state treasury. Rider 2 of previous General Appropriations Acts gave districts this authority, but the current Rider 2 does not. When the rider changed, the Board should have sought clarification of legislative intent.

At present, the Board does not compile information on the financial activities of districts. As a result, the Board does not have access to information that would help it determine the amount of state funds potentially subject to lapse (depending on further clarification). The lack of this information precludes the governing board and other decision makers from answering such basic questions as: How much in state funds is held in local district bank accounts? What are the sources of district revenues? How much in federal revenues do districts receive that is not budgeted through the state appropriations process?

Recommendations

To strengthen its oversight of expenditures made or approved by local districts, we recommend that the Board:

- Develop a quality assurance function to review a statistical sample of cost-share contracts. This review should include verification of the amounts actually paid to vendors and verification that contracts involving local district directors were appropriately disclosed. It should also include analytical procedures to identify questionable relationships between landowners and vendors.
- Provide additional guidance to landowners on selecting a vendor, preferably by means of competitive bidding.
- Develop additional controls for circumstances in which the landowner or a related party is also the contractor.
- Develop and include in its Manual of Fiscal Operations a specific procedure for local districts on how to identify and address potential instances of fraud.
- Work with the Legislative Budget Board to develop rider language to clarify the current Rider 2.

- Compile the results of district financial reports and make this information available to the governing board, state oversight agencies, and state decision makers. Using this data, the Board should calculate the amount of state balances held in local accounts that could be subject to lapse.

Management's Response

Management concurs with developing a quality assurance function for agency contracts, providing additional guidance to landowners on selecting vendors through a competitive bid process, and developing a fraud policy to be adopted by all local Soil and Water Conservation Districts. The agency will work to further develop and implement these recommendations by August 2004.

Management will evaluate developing additional controls for circumstances in which landowners contract with themselves and processes for compiling district financial reports. Agency leadership will continue to work with the Legislative Budget Board to clarify the intention behind Rider 2 of the General Appropriation Act.

Chapter 2-B

The Board Generally Safeguards Its Physical, Cash, and Information Technology Assets

In general, the Board safeguards its physical, cash, and information technology assets. It can improve its ability to do so by addressing the following:

- The Board has not segregated the purchasing, receiving, and inventory functions. This weakness could allow for the misappropriation of purchased items. However, our testing of expenditures for physical assets did not identify any questionable purchases.
- When we started this audit in October 2003, the Board began recording deposits in a cash log, but it was not restrictively endorsing checks. The Board reports that it has corrected this weakness, and the deposit log for fiscal year 2004 indicates timely deposits (within three days of receipt) with one exception (within nine days of receipt).

Recommendations

To improve controls over physical, cash, and information technology assets, we recommend that the Board:

- Segregate its purchasing, receiving, and inventory functions.
- Continue recording deposits in its cash log and restrictively endorsing checks.

Management's Response

Management concurs. Recommendations have already been implemented.

Administrative and Total Expenditures for Fiscal Years 2000-2003

The Board was appropriated \$538,265 for its indirect administration strategy for each year of the 2002–2003 biennium. As Table 1 indicates, the Board’s actual expenditures for these years exceeded its appropriations by 16 percent and 5 percent, respectively. These overages were within the Board’s authority to transfer funds across strategies, and the transfers from other strategies did not exceed 25 percent.

Table 1

Expenditures for Indirect Administration				
Category of Expense	FY00	FY01	FY02	FY03
Salaries and Wages	\$ 425,198.62	\$ 443,875.36	\$ 472,522.85	\$ 424,294.40
Travel	38,973.81	43,250.19	41,034.79	37,018.71
Rentals and Leases	29,098.72	29,189.01	25,291.78	32,723.53
Other Expenditures	15,404.15	10,503.99	21,412.84	27,717.63
Professional Services and Fees	866.58	3,534.17	18,726.07	14,507.14
Communication and Utilities	4,529.45	8,140.90	8,786.81	9,076.54
Supplies and Materials	7,453.55	4,119.57	6,190.63	6,512.67
Other	12,472.45	13,292.66	30,429.07	13,090.36
Total	\$533,997.33	\$555,905.85	\$624,394.84	\$564,940.98

Note: The strategy “Indirect Administration” does not include all central office functions because some central staff positions are paid from program funds. Here, it refers primarily to executive/ administrative management and the fiscal office.

Source: Uniform Statewide Accounting System

Expenditures by Appropriation

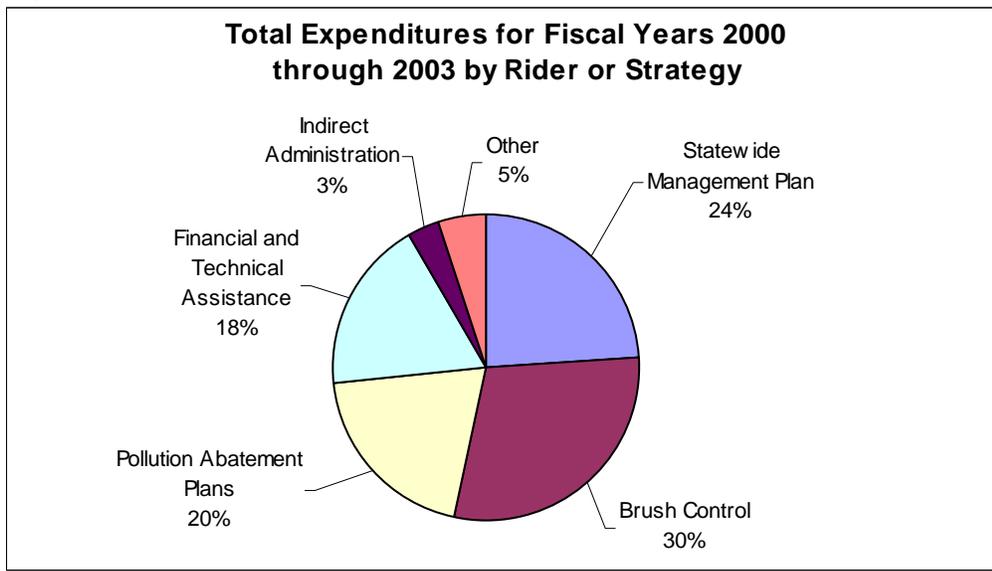
As Table 2 shows, the Board’s expenditures for its Brush Control program totaled \$11.4 million in fiscal year 2003, a significant increase over the previous fiscal year. Expenditures for all the strategies that provide funds to landowners for specific projects, including Brush Control, totaled \$13.8 million. As Figure 1 shows, the Board’s indirect administration expenditures represented 3.5 percent of the Board’s total expenditures for fiscal years 2000 through 2003.

Table 2

Board Expenditures by Rider or Strategy					
Strategy or Rider	FY00	FY01	FY02	FY03	Totals
Statewide Management Plan	\$2,440,574.07	\$4,992,048.30	\$3,927,402.45	\$4,158,292.13	\$15,518,316.95
Brush Control	1,493,072.71	2,732,530.35	3,507,046.84	11,435,291.89	19,167,941.79
Pollution Abatement Plans	2,987,634.99	3,392,739.39	3,502,836.50	3,234,631.92	13,117,842.80
Financial and Technical Assistance	2,814,566.76	2,983,320.29	2,991,985.42	3,070,451.33	11,860,323.80
Indirect Administration	533,997.33	555,905.85	624,394.84	564,940.98	2,279,239.00
Other	710,901.23	763,685.79	816,989.71	887,939.08	3,179,515.81
Totals	\$10,980,747.09	\$15,420,229.97	\$15,370,655.76	\$23,351,547.33	\$65,123,180.15

Source: Uniform Statewide Accounting System

Figure 1



Source: Uniform Statewide Accounting System

Chapter 4

Is the Board making progress toward its goals and objectives?

In general, the Board reports that it meets most of its performance targets. However, our 2001 performance certification audit was not able to fully certify the results for any of the selected measures. This audit confirmed that the Board lacks procedures and definitions needed to ensure accurate performance reports. Without reliable, accurate performance data, we are unable to determine conclusively if the Board has made progress toward its goals and objectives.

However, the Board has recently developed monthly status reports on its activities and programs. Board staff provides these monthly reports to the governing board and other interested parties. The reports include output, explanatory, and other performance measures for some programs and activities that appear to be more descriptive than those included in the Board's Strategic Plan and LAR. These detailed reports are descriptive and measurable; they suggest that, at the program level, the Board is tracking and managing its performance. But without a direct link between the reports and the Board's official performance measures, we lack assurance that targets for objectives and strategies are being achieved.

Recommendations

The Board should:

- Develop detailed procedures to ensure accurate and consistent performance reports. The procedures should include the review and approval of performance data to be entered into ABEST.

- Develop standard performance reports to be submitted to the governing board in open meetings. These reports could be modeled after the monthly reports described above.

Management's Response

Management concurs. Performance reports to the governing board will be implemented immediately. The Fiscal Officer will develop and implement detailed procedures by August 2004.

Chapter 5

Does the Board comply with applicable laws and regulations?

With the exception of not submitting some required reports (as discussed in Chapter 1), the Board generally complies with key requirements in the Government Code, the Agriculture Code, and the General Appropriations Act. For example, the Board complies with key Open Meetings and Open Records requirements, appears to substantially comply with riders from the General Appropriations Act (77th and 78th Texas Legislatures), and has adopted the standards of conduct for board members required by the Agriculture Code. However, we noted that at present, the Board does not maintain the complaint file required by paragraph 201.0231 of the Agriculture Code. We further noted that Section 201.129 of the Agriculture Code requires surety bonds for state board members, and Section 201.179 requires surety bonds for local board members. Because of the infrequency of claims on surety bonds, other state agencies may purchase them only with approval from the State Office of Risk Management.

Recommendations

The Board should establish and maintain a complaint file in accordance with paragraph 201.0231 of the Agriculture Code. It should consider working with the Legislature to make its requirement for the purchase of surety bonds, for itself and for districts, consistent with requirements for other state agencies.

Management's Response

Management concurs. The Special Projects Officer has already established a complaint file. Agency leadership will work with the Legislature to evaluate the purchase of surety bonds.

Project Information

Fieldwork was conducted between October 2003 and February 2004. The following members of the State Auditor's staff performed the work:

- John Swinton, CGFM, MPAff. (Project Manager)
- Jeff Grymkoski
- Gary Leach, CQA
- Robert "Bob" Woodward
- Chuck Dunlap, CPA (Quality Control Reviewer)
- Julie Ivie, CIA (Audit Manager)
- Frank Vito, CPA (Audit Director)

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