

Secretary of State Audit Report



Report Number 2010-01

Date: January 2010

Baker Valley Soil and Water Conservation District: Opportunities Exist for Improved Project Management

Executive Summary

This audit was conducted to determine the validity of allegations we received through the Government Waste Hotline relating to state funds granted to the Baker Valley Soil and Water Conservation District (District) for the Powder River Water Quality Enhancement Project (project) in Baker Valley.

From February 2005 through March 2008 the District received about \$1.5 million in state funds from the Oregon Watershed Enhancement Board and the Oregon Department of Environmental Quality to construct the Powder River Quality Enhancement Project (project). The project included the construction of an 11 mile pipeline, allowed for improved fish passage, and allowed for the restoration of degraded riparian vegetation along the Powder River. The project was substantially completed in 2008.

In February 2009, we received allegations that project funds had been mismanaged. We began an audit to determine the validity of the allegations. In addition, we determined whether the District had implemented selected internal controls over financial transactions to safeguard public funds against loss from unauthorized use or disposition.

We found that only one of the allegations received through the hotline had merit. In accordance with ORS 177.180(2), any allegations that we could not verify remain confidential and are not included in this report. The one allegation we substantiated related to a lack of compliance with public contracting laws. The District

was unable to document that it solicited bids and entered into formal contracts for all key services and materials. As a result, the District could not ensure it obtained the best price for the services and materials purchased; the District could not demonstrate vendor selections were impartial; and the District limited its legal options if vendors had provided substandard services and materials.

Regarding the District's internal controls, we found that the District generally had adequate controls to ensure expenditures were authorized and disbursed for appropriate purposes. However, we identified some conditions the District could address to better identify related parties and conflicts of interest stemming from related-party transactions.

We recommend the District's Board and District management:

- comply with applicable requirements of the public contracting laws on future projects and ensure formal contracts are executed to protect the District's interests and public funds; and
- ensure conflicts of interest are appropriately disclosed in compliance with Oregon laws and develop policies and procedures for the disclosure and treatment of conflicts of interest.

Agency's Response

The Baker Valley Soil and Water Conservation District's response is included at the end of this report.

Introduction

The Baker Valley Soil and Water Conservation District (District) provides conservation services to landowners and other natural resource users in Baker Valley. It cooperates with other local, state, and federal governments in projects, programs and activities to conserve, protect and develop renewable natural resources of the area. The District is governed by a board of seven directors (Board) elected by the citizens. The District employs a manager and several staff who split their time between the District and three other soil and water conservation districts in the area.

From February 2005 through March 2008, the District received about \$1.5 million in state funds from the Oregon Watershed Enhancement Board and the Oregon Department of Environmental Quality to complete the Powder River Quality Enhancement Project (project). The project improved livestock watering through the construction of an 11 mile pipeline, which included 42 troughs installed in pastures that were cross fenced for grazing management. The project also improved in-stream passage for native and introduced fish species by the removing of six dams and the installation of fourteen rock weirs to raise the height of the water surface. Finally, the project restored the degraded riparian vegetation by planting 6,000 willow sprigs and several willow clumps along approximately three miles of riverbank. The project was begun in 2004 and was substantially completed in 2008.

In February 2009, we received allegations through the Government Waste Hotline that the project funds had been mismanaged. As a result, we began an audit to determine the validity of the allegations and to determine whether the District had ensured controls were in place to safeguard public funds against loss from unauthorized use or disposition.

Audit Results

We found that only one of the allegations received through the hotline had merit. In accordance with ORS 177.180(2), any allegations that we could not verify remain confidential and are not included in this report. The one allegation we substantiated related to a lack of compliance with public procurement laws. The District's practice during the project was to generally engage vendors and purchase materials without soliciting competitive quotes or bids and without entering into formal contracts. As a result, the District could not ensure it had obtained the best price for services and materials purchased; the District could not demonstrate that it had selected vendors impartially; and the District limited its legal options if vendors had provided substandard services and materials.

Regarding internal controls, we found that the District generally had adequate controls to ensure expenditures were authorized and disbursed for appropriate purposes. However, the District could better identify related parties and related-party transactions to minimize the risk of conflicts of interest.

Disregarding Public Contracting Laws Can Impair Objectivity, Pricing, Legal Options

The District could not provide sufficient documentation to demonstrate compliance with the applicable public contracting laws when obtaining services and materials for the project. The District was also unable to provide formalized agreements or contracts with the vendors that provided the services and materials. As an Oregon municipal corporation, the District is required to follow applicable public contracting laws. In October 2004, coinciding with the start of the project, the Board adopted the *Attorney General's Public Contracts Manual* as its contracting rules. The manual incorporates applicable Oregon statutes and administrative rules for the Public Contracting Code (contracting code). The contracting code embodies the essence of the policy of the state of Oregon, which is to foster open and impartial competition with the aim of obtaining services and materials at a fair and reasonable price. The contracting process involves determining that services or materials are needed, identifying applicable portions of the contracting code, soliciting competitive quotes or bids, selecting a winning proposal in response to the solicitations, negotiating contract terms, executing a formal contract, receiving contracted services or materials, and making payments according to contract provisions.

In completing the project, the District made payments to 64 separate vendors. Fifteen vendors received total payments between \$5,000 and \$75,000; seven vendors received total payments in excess of \$75,000, including one vendor that received total payments of about \$394,000. The contracting code generally requires competitive pricing for services and materials that exceed \$5,000 and a written solicitation to obtain quotes, bids and proposals for procurements equal to or greater than \$75,000. The District could not provide evidence that competitive pricing was obtained for most of the services and materials purchased.

In completing construction projects of this magnitude, it is important to have written documents in place that identify involved parties and their responsibilities, deliverables, agreements, and parameters. This helps ensure the District's interests and public funds are protected. Some significant purchases for the project included engineering services, excavating services, pipeline, fencing materials and concrete. Although the District was able to provide documentation that price quotes and bids were obtained for some of the materials

relating to the project, the District was unable to demonstrate that bids were obtained for key aspects of the project, such as excavation services. Furthermore, the District could not provide evidence of formal contracts with any of the vendors that provided services or materials for the project.

As a result, the District could not ensure it had obtained the best price for services and materials purchased; the District could not demonstrate it had selected vendors impartially; and the District limited its legal options had vendors provided substandard services and materials.

We recommend District management comply with applicable requirements of the public contracting laws on future projects and ensure formal contracts are executed to protect the District's interests and public funds.

Related-Party Transactions Increase Risk of Conflicts of Interest

A related-party transaction is a business arrangement between two parties who are joined by a special relationship prior to the arrangement. Examples of individuals who are usually considered related parties include members of an entity's board of directors, members of management who perform policymaking functions, members of the immediate families of the board of directors and management, and other parties that can influence the management or operating policies of an entity. While transactions between related parties occur in the normal course of business and are usually not inappropriate, the special relationship inherent between the involved parties creates potential or actual conflicts of interest which can result in actions that benefit the people involved and can be detrimental to the public's trust in that entity. Oregon laws have specific disclosure requirements for public officials, including board members and employees, facing potential or actual conflicts of interest.

During the project, the District entered into some related-party transactions that may have represented potential or actual conflicts of interest. For example, the engineering firm for the project subcontracted with the board chair to serve as project manager. In addition, the board chair had a financial interest in two vendors that collectively received about \$25,000 for services for the project. It was noted in board meeting minutes that the board chair had provided a written declaration of a conflict of interest on one occasion and abstained from voting on decisions relating to other projects. However, the board minutes did not reflect that the board chair publicly declared the nature of his conflict of interest on each occasion as required by Oregon laws and the board minutes did not document that the board chair abstained from votes directly relating to the Powder River Water Quality Enhancement Project.

Furthermore, some of the Board members knew that the district manager had a relationship with one of the District's vendors, but not all Board members knew that the district manager was also this vendor's bookkeeper. We noted that the district manager did not have authority to direct work to the vendor; this responsibility was assigned to the project manager. In addition, although the district manager prepared the checks to pay invoices, the project manager reviewed and approved most of the invoices for payment, and the board treasurer also reviewed the invoices and signed the checks. Some of the Board members may not have been aware of the district manager's additional relationship with the vendor because the District does not have a formal policy requiring the disclosure of conflicts of interest or procedures to address the treatment of conflicts of interest.

In compliance with ORS 177.180(3)(a), we will communicate the above issues to the Oregon Government Ethics Commission.

We recommend the Board and District management ensure future conflicts of interest are appropriately disclosed in compliance with Oregon laws. **We also recommend** the District management develop policies and procedures for disclosure and treatment of conflicts of interest.

Objectives, Scope and Methodology

The objectives of our audit were to determine the validity of allegations received through the Government Waste Hotline and to determine whether the District had implemented selected internal controls over financial transactions to safeguard public funds against loss from unauthorized use or disposition.

The scope of our audit was limited to evaluating the receipt and expenditure of approximately \$1.5 million of state funds granted to the District between February 2005 and March 2008 for the project.

To meet the objectives of the audit, we analyzed data from the state's accounting system, obtained and examined relevant supporting documentation from the state agencies that provided funding to the District, reviewed applicable laws, rules and policies, and made inquiries of personnel at the Oregon Watershed Enhancement Board and Oregon Department of Agriculture. We also made inquiries of District management and staff and the District's Board of Directors, reviewed supporting expenditure documentation at the District's office in Baker City, Oregon, and analyzed data from the District's accounting and banking records.

We conducted this performance 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 believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.



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October 5, 2009

Secretary of State
Audits Divisions
255 Capitol St. NE, Suite 500
Salem, OR 97310

Attn: Dale Bond

Re: Baker Valley Soil and Water Conservation District

Dear Dale:

The following is the Baker Valley Soil and Water Conservation District Board of Directors response to your audit report. Please include these comments in your final report.

Background

The Powder River Water Quality Enhancement Project was a landowner driven project that was directed by the Baker Valley SWCD (DISTRICT). The funds were applied for and awarded to the DISTRICT and in good faith the DISTRICT implemented the project. Funding was provided by numerous public funding agencies and the landowners. The purpose of the project was to improve water quality on the Powder River. This was accomplished by fencing 13 miles of river to remove livestock, installing 120 watering facilities to provide off-stream water for the livestock, and restore the riparian area along the river to provide erosion control and habitat for wildlife.

Phase I of the project included two landowners and four miles of the river. After, the project was set in motion additional funding was acquired to implement nine extra miles which included 12 additional landowners; expanding the project to three phases.

It was intended for the Baker Valley Irrigation District, who would ultimately own and maintain the main infrastructure of the project, to act as the contractor for the project and the DISTRICT would be the fiscal agent. However, once the project started the Irrigation District found it was too busy to complete the project in a timely manner and due to funding deadline the DISTRICT was forced to resume management of the project.

In Phase I of the project, we have documentation (attached) showing, we took bids for the procurement of numerous of the larger ticket items. After obtaining several quotes we



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quickly learned which vendors would provide us with the best prices. Once we began purchasing items some of the vendors were not willing to give us prices because they knew they were not able to compete. We followed public contracting law by advertising and taking competitive bids for the engineering portion of the project. The Irrigation District hired and supervised all the sub-contractors who preformed the work; however, they were paid through the DISTRICT.

Sequentially, once the project began there were factors that influenced the actions of the DISTRICT including hurricane Katrina affecting the price and availability of materials, the increase in the price of fuel causing pipe prices to increase daily. Extreme weather conditions in our area and irrigation season limited the window of opportunity for the installation of the project. Furthermore, in the middle of the project, the District Manager left the employment of the DISTRICT leaving a void in the continuity of the fiscal management.

Ultimately, despite adverse factors, the project was completely implemented and all aspects of the project were accomplished within the timelines set by the funding sources. The landowners and funding agencies are pleased with the project and its overall benefits to the watershed. The project has been recognized on a local, state, and national level for its success and innovation.

Audit Results

The Secretary of State Office conducted an audit of this project based on allegations received through their hotline for tips regarding waste of public funds. The Directors of the DISTRICT would first like to thank the Staff of the Audits Division for the courtesy and professionalism that they exemplified in this process. As to the findings of the Audit, in regards to the fist allegation, “Disregarding Public Contracting Laws”, the Baker Valley SWCD Directors acknowledge that while there was intent to comply with Public Contract Law, the DISTRICT did not follow the law in its entirety mostly due to extenuating circumstances. In the mid-project they recognized that they had failed to follow the proper steps of public contracting but implementation was in progress and due to time and funding constraints the work had to go forward. However, competitive pricing was always considered when implementing this project.

As to the second allegation, “Related-Party Transactions”, the Baker Valley SWCD Directors acknowledge that mistakes were made by lack of knowledge of what constitutes a “related-party” transaction and an actual conflict of interest. While there was intent to declare the conflicts and abstain from votes pertaining to the project, Directors acknowledge that it may not have been documented properly and they were negligent in addressing the issues. However, the Directors believe that there was no fraud or intent of any personal gain involved in the processes.



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Resolution

Public Contracting Law

The District has adopted a resolution accepting the Attorney General's Public Contract Manual for contracting rule. Additionally, we have a new District Manager who understands Public Contract Rule and is making every effort to comply with the rules. She will be attending courses on Public Contracts biannually and will keep the Directors informed of the rules and any changes that affect the rules. All projects that have been implemented since the Powder River Water Quality Enhancement Project have followed Public Contract Law including competitive bidding processes and formal contracts.

Related Party Transactions

The District has worked with Oregon Department of Agriculture to conduct an operational review to improve the overall operation of the District including identifying related party transactions and conflicts of interest. The Directors have appointed a policy committee that is establishing policy for handling conflicts of interests and related party transactions, as well as other issues concerning the DISTRICT

Additionally, the District has had independent financial audits for the past two fiscal years. Both audits were conducted in conjunction with the Powder River Water Quality Enhancement Project. Moreover, we are working with an independent accounting firm to review our accounting and record keeping processes to ensure that we are complying with the internal controls recommended by the independent auditor.

In conclusion, the Baker Valley Soil and Water Conservation District Directors and Staff believe that they properly and responsibly used the public's money to implement this project. The positive impacts of the Powder River Water Quality Enhancement Project far out-weigh any error that the Board may have made. An economic impact study was conducted on this project. The results showed that the project created 37 jobs and one new business. A total 3.4 million dollars was put into the project which created a multiplier of \$1.58 which means the total input into the communities economy was \$5.37 million dollars. There were numerous lessons learned from this project which the Baker Valley SWCD will use in the implementation of future projects.

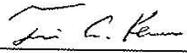
Once again, we appreciate the courtesy and professionalism of the Audit Staff. The Directors, Staff and landowners who put their time and effort into this project are disappointed that the integrity of the project is being questioned. We hope that through this process that the results of the audit will serve to alleviate any questions or concerns citizens may have about the use of public funds by the Baker Valley SWCD.



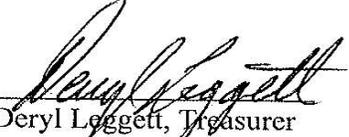
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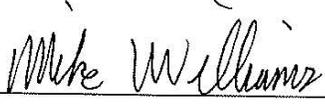
Regards,



Tim Kerns, Chairman
Baker Valley SWCD



Deryl Leggett, Treasurer
Baker Valley SWCD



Mike Williams, Vice-Chairman
Baker Valley SWCD



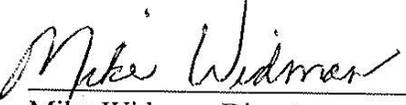
Jim Colton, Director
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Courtesies and cooperation extended by officials and staff of the Baker Valley Soil and Water Conservation District, Oregon Watershed Enhancement Board, Oregon Department of Agriculture, and Oregon Department of Environmental Quality were commendable and much appreciated.

This report, a public record, is intended to promote the best possible management of public resources. Copies may be obtained:

Internet: <http://www.sos.state.or.us/audits/index.html>

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