OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Financial-Related Audit

Environment and Natural Resources Trust Fund
Two Fiscal Years Ended June 30, 1999

OCTOBER 13, 2000 **00-48**

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 fifty 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 and one best practices review.

OLA is under the direction of the Legislative Auditor, who is appointed for a six-year term by the Legislative Audit Commission (LAC). The LAC is a bipartisan commission of Representatives and Senators. It annually selects topics for the Program Evaluation Division, but is generally not involved in scheduling financial audits.

All findings, conclusions, and recommendations in reports issued by the Office of the Legislative Auditor are solely the responsibility of the office and may not reflect the views of the LAC, its individual members, or other members of the Minnesota Legislature.

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If you have comments about our work, or you want to suggest an audit, investigation, evaluation, or best practices review, please contact us at 651-296-4708 or by e-mail at auditor@state.mn.us

Representative Dan McElroy, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Senator Leonard Price, Chair
Legislative Commission on Minnesota Resources

Mr. John Velin, Director
Legislative Commission on Minnesota Resources

Mr. Allen Garber, Commissioner
Department of Natural Resources

Mr. Mark Yudof, President
University of Minnesota

We have audited selected appropriations made from the Environment and Natural Resources Trust Fund for the period July 1, 1997, through June 30, 1999, as further explained in Chapter 1. Our audit scope included selected projects administered by the Department of Natural Resources and the University of Minnesota.

We have conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards, as issued by the Comptroller General of the United States. These standards require that we obtain an understanding of management controls relevant to the audit. These standards also require that we design the audit to provide reasonable assurance that the Department of Natural Resources and the University of Minnesota complied with the provisions of laws, regulations, contracts, and grants significant to the audit. The management of the Department of Natural Resources and the University of Minnesota are responsible for establishing and maintaining the internal control structure and to comply with applicable laws, regulations, contracts, and grants.

This report is intended for the information of the Legislative Audit Commission, the Legislative Commission on Minnesota Resources, management of the Department of Natural Resources, and management of the University of Minnesota. This restriction in not intended to limit the distribution of this report, which was released as a public document on October 13, 2000.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: June 23, 2000

Report Signed On: October 9, 2000

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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
Cecile Ferkul, CPA, CISA	Audit Manager
Jack Hirschfeld, CPA	Auditor-In-Charge (U of M)
Anthony Toscano	Auditor-In-Charge (DNR)
Tory Monson	Auditor (DNR)
Patrick Phillips, CPA	Auditor (U of M)

Exit Conference

We discussed the results of the audit with the following staff:

University of Minnesota:	
Mike Volna	Interim Controller
Joan Donaldson	Director, Sponsored Financial Reporting
Sue Paulson	Supervisor, Sponsored Financial Reporting
Bev Durgan	Associate Dean for Research and Outreach
Helene Murray	Principle Investigator, Agronomy
Frank Pfleger	Department Head, Plant Pathology
Linda Kinkel	Principle Investigator, Plant Pathology
Laurie Brand	Supervisor, Plant Pathology
Department of Natural Resources:	
Steve Morse	Deputy Commissioner
Peggy Adelmann	Chief Financial Officer
Bill Becker	LCMR Liaison

Report Summary

The Environment and Natural Resources Trust Fund was established in 1988 to use investment earnings from net lottery proceeds for the protection, conservation, preservation, and enhancement of the state's air, water, land, fish, wildlife, and other natural resources. The Legislative Commission on Minnesota Resources (LCMR), consisting of 20 members of the Legislature, oversees the distribution of the trust fund monies. For fiscal years 1998 and 1999, the Legislature appropriated the majority of trust fund monies for projects conducted by the University of Minnesota and the Department of Natural Resources. The Department of Natural Resources was the pass-through agent for many of the non-state projects.

Key Findings and Recommendations

- The University of Minnesota used approximately $21,000 for project costs that may not have been eligible for reimbursement from the trust fund. The university also did not timely submit final project and expenditure reports. We recommended that the university work with LCMR to determine whether the costs charged to these projects were eligible for reimbursement. We also recommended that the university submit required project reports in a timely manner. (Findings 1 and 2, pages 9 and 10)
- The Department of Natural Resources (DNR) purchased equipment totaling $6,296 after the end date of a project. We recommended that DNR reimburse the Environment and Natural Resources Trust Fund for this expenditure. (Finding 3, page 12)
- DNR personnel did not adequately administer one of the LCMR grants. DNR inappropriately paid the grant to a subrecipient on a pro rata basis rather than paying the subrecipient on a reimbursement basis. DNR personnel did not review project costs to determine that the subrecipient used the funds for eligible costs. The subrecipient may need to repay about $69,000 for ineligible costs. We recommended that DNR review the subrecipient's project costs, determine the eligibility of the costs, and request repayment for those costs found to be ineligible. (Finding 4, page 12)

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Chapter 1. Introduction

An amendment to the state constitution in 1988 established the Environment and Natural Resources Trust Fund. Article XI, Sec. 14 of the Constitution of the State of Minnesota, as amended again in November 1990, provides, in part:

> The principal of the environment and natural resources trust fund must be perpetual and inviolate forever, except appropriations may be made from up to 25 percent of the annual revenues deposited in the fund until fiscal year 1997 and loans may be made of up to five percent of the principal of the fund for water system improvements as provided by law . . .The net earnings from the fund shall be appropriated in a manner prescribed by law for the public purpose of protection, conservation, preservation, and enhancement of the state's air, water, land, fish, wildlife, and other natural resources. Not less than 40 percent of the net proceeds from any state-operated lottery must be credited to the fund until the year 2001.

The state's constitution was again amended in November 1998 to limit the amount available for appropriation each biennium at 5½ percent of the fund's market value.

The Minnesota State Lottery deposited net lottery proceeds to the trust fund each month. The State Board of Investment invested trust fund money as required by statutory provisions. Investment income was available for expenditure. The Legislature authorized expenditures of varying percentages of revenues within the constitutional limitation.

Table 1-1 shows the trust fund corpus financial activity for fiscal years 1998 and 1999.

Table 1-1
Environment and Natural Resources Trust Fund - Nonexpendable Trust Fund
Summary of Financial Activity
Fiscal Years 1998 and 1999

	1998	1999
Beginning Fund Balance	$185,644,000	$ 243,882,000
Lottery Proceeds	24,708,000	23,210,000
Investment Income	39,132,000	33,944,000
Transfers Out to Expendable Trust Fund	(7,065,000)	(11,578,000)
Funds Returned from Expendable Trust Fund	1,463,000	63,000
Ending Fund Balance	$243,882,000	$289,521,000

Note: Constitutional and statutory provisions allow for the transfer of trust fund earnings to the Expendable Trust Fund (see Table 1-3) for expenditure in accordance with appropriation restrictions. Any appropriated funds not encumbered in the biennium for which they were appropriated canceled and were transferred back to the trust fund corpus. Additional funds returned from the fiscal years 1998 and 1999 appropriations would be credited to fiscal year 2000.

Source: State of Minnesota Comprehensive Annual Financial Reports and supporting accounting records.

Environment and Natural Resources Trust Fund

During our annual audits of the state's financial statements, we verified the propriety of revenue deposited to the trust fund. We performed tests of investment income at the State Board of Investment and verified the proper distribution of lottery proceeds to the trust fund and the appropriate allocation of revenues between fund corpus and expendable balance.

Legislative Commission on Minnesota Resources

The Legislative Commission on Minnesota Resources (LCMR) oversees the distribution of the trust fund monies. The LCMR, consisting of 20 members of the Legislature, solicits and reviews project applications and makes recommendations to the Legislature to fund projects. In addition, it adopts a six-year strategic plan identifying priority areas for funding. LCMR employs staff to assist in its responsibilities. Mr. John Velin serves as LCMR director.

The Legislature intended that the trust fund supplement traditional sources of funding for environmental and natural resource activities. Minn. Stat. Section 116P.08 identifies the types of projects and administrative costs that can use trust fund monies. Section 116P.11 defines the amount available for expenditure each biennium.

The LCMR's main responsibilities were to identify project areas, solicit project proposals, evaluate project proposals, and make recommendations to the Legislature. The LCMR issued a request for proposal (RFP) for projects to be funded in the 1998-1999 biennium. The RFP contained the project funding intentions and a list of potential project areas. The LCMR made the RFP available to the public via newsletters, forums and meetings, and through its website. The LCMR also had a mailing list of approximately 3,500 interested parties.

The LCMR staff sorted over 400 proposals by project area and ranked the individual projects. Some proposals came from state agencies and others came from non-state entities. A Citizens Advisory Committee performed an initial review of the projects to determine which projects best met the LCMR objectives. A peer review panel of experts also conducted a separate review to determine the potential success and impact of proposed projects. In some cases, the LCMR also requested additional information and appearances by some project managers.

LCMR recommended specific projects to the Legislature in a biennial budget plan for fiscal years 1998-1999. The Legislature gave final approval for 51 projects. The Legislature appropriated funds for each approved project. If a project was administered by a non-state entity, the Legislature appropriated funds to a state entity that passed-through the funds to the non-state entity. The Department of Natural Resources was the pass-through agent for many of the non-state projects.

Table 1-2 shows trust fund appropriations for the 1998-1999 biennium.

Table 1-2
Environment and Natural Resources Trust Fund
Fiscal Years 1998 and 1999 Appropriations

Department	Number of Projects	Appropriation Amount
Natural Resources	29	$ 17,012,000
University of Minnesota	10	2,573,000
Pollution Control Agency	4	1,250,000
Historical Society	2	333,000
Agriculture	1	150,000
MnSCU	2	315,000
Board of Water and Soil Resources	2	165,000
LCMR Administration	N/A	472,000
Totals	50	$22,270,000

Source: Laws of Minnesota for 1997.

State agencies receiving trust fund appropriations were responsible for administering approved projects and, if applicable, monitoring appropriations that flowed-through to other entities. As a condition of acceptance of trust fund appropriations, agencies and other entities submitted a work program and semiannual progress reports to LCMR. A statutory provision required that the LCMR approve the work program before an agency could spend trust fund appropriations.

Table 1-3 shows financial activity for the expendable portion of the trust fund for fiscal years 1998 and 1999.

Table 1-3
Environment and Natural Resources Trust Fund
Expendable Trust Fund
Summary of Financial Activity

	Fiscal Year 1998	Fiscal Year 1999
Beginning Fund Balance	$8,847,000	$3,930,000
Revenue and Other Sources:		
Transfers In from Nonexpendable Trust Fund	7,065,000	11,578,000
Investment Income	398,000	202,000
Other Revenues	4,000	0
Total Revenues and Other Sources	$ 7,467,000	$11,780,000
Expenditures and Transfers Out:		
Current Expenditures	$ 3,078,000	$ 3,707,000
Capital Outlay	1,993,000	2,507,000
Pass-Through Appropriations	1,377,000	3,527,000
Transfers to Component Units	4,473,000	1,089,000
Total Expenditures and Transfers Out	$10,921,000	$10,830,000
Funds Returned to the Nonexpendable Trust Fund	1,463,000	63,000
Ending Fund Balance	$ 3,930,000	$ 4,817,000

Note: Following constitutional and statutory provisions, transfers were made from the trust fund corpus for expenditures in accordance with appropriation restrictions. Any appropriated funds not encumbered in the biennium for which they were appropriated cancel and were returned to the Nonexpendable Trust Fund. The Ending Fund Balance at June 30, 2000, will either be used to reimburse projects for final project costs, returned to the non-expendable Environment and Natural Resources Trust Fund for reappropriation, or in limited instances, carried forward to fiscal year 2000 for projects with extended end dates.

Source: State of Minnesota Comprehensive Annual Financial Reports and supporting accounting records.

Environment and Natural Resources Trust Fund

In the following chapters, we discuss the results of our audit work performed at the University of Minnesota and the Department of Natural Resources. As explained in those chapters, we found instances where recipients may have used trust fund monies inappropriately. The LCMR lessened the risk that funds would be used inappropriately by making the following improvements in their grant process:

- Some of the exceptions noted resulted from noncompliance with LCMR's verbal policies. For example, LCMR staff stated to the auditors that they required prior approval of any out-of-state travel. The LCMR included this requirement in written policies for the fiscal year 2002/2003 appropriations, making it easier for recipients to understand the program guidelines and comply with them.

- Other questions arose about whether certain costs were eligible for reimbursement from the Trust Fund. Although the LCMR generally prohibited the recovery of indirect costs, in some cases it did allow similar costs. For example, LCMR did not usually allow rent and administrative overhead (typical indirect costs) but made exceptions if recipients could define these costs as direct project costs. For its 2002/2003 appropriations, the LCMR will prohibit any reimbursements for rent.

Chapter 2. University of Minnesota

Chapter Conclusions

The University of Minnesota may have charged some ineligible costs to the LCMR project appropriations. The university did not timely submit some final reports for the projects.

The University of Minnesota received $2,573,000 from the Environment and Natural Resources Trust Fund for ten projects during the 1998-1999 biennium. The procedures for the university obtaining and accounting for these appropriations involved several steps. The university submitted applications for projects addressing areas listed in the LCMR Request for Proposal. Once LCMR approved the projects, the university established a separate budget on its accounting system for each project.

The university assigned each project manager the responsibility to monitor project progress and costs charged against the appropriation. The university also was to submit work plans periodically to the LCMR advising them of the status of the projects and current expenditure amounts, with a final work plan due on June 30, 1999.

We reviewed two projects: Sustainable Farming Systems and Crop Management to Minimize Pesticide Inputs. The appropriations for these two projects totaled $860,000.

- The objective of the "Sustainable Farming System" project was to develop a comprehensive program to educate and demonstrate the economic and environmental effects of sustainable farming systems. The project involved farm-based data collection and research. The LCMR appropriation for this project was $560,000. The university established contracts with three non-profit entities and an individual to coordinate and assist team members in completing project objectives. The LCMR continued this project with a new appropriation for the 2000-2001 biennium.

- The "Crop Management to Minimize Pesticide Inputs" project's objective was to develop non-pesticide management strategies for pest control for crops. The LCMR appropriation for this project was $300,000. This project contributed to the development of non-pesticide management strategies for significant agricultural pests.

Table 2-1 provides a summary of the expenditures charged to these projects.

Table 2-1
LCMR Appropriations to the University of Minnesota
Fiscal Years 1998 and 1999

Projects:	Sustainable Farming Systems	Crop Management to Minimize Pesticide Inputs
Appropriation Amount	$560,000	$300,000
Expenditures:		
Salaries	$ 99,244	$197,361
Contracts	321,473	0
Supplies	70,721	66,729
Travel	7,677	7,191
Equipment	58,627	26,497
Total Expenditures	$557,742	$297,778
Unspent Balance (1)	$ 2,258	$ 2,222

Note 1: The university returned $2,258 to LCMR from the appropriation for the Sustainable Farming Systems project. The university had not returned $2,222 for the Crop Management project as of June 30, 2000.

Source: University of Minnesota accounting records.

Audit Objective and Methodology

Our review focused on the following objective:

- Did the University of Minnesota's expenditures of trust fund appropriations comply with statutory provisions and other significant finance-related legal provisions and occur within the authorized period?

To answer this question, we made inquiries of university staff to gain an understanding of the internal control structure over project expenditures. We analyzed expenditures to determine the proper recording of project expenditures, reviewed source documentation supporting expenditures, and tested expenditures to ensure proper amounts were charged to the individual projects. We also reviewed expenditures to determine if the university complied with applicable legal provisions.

Conclusions

The University of Minnesota may have charged some ineligible costs to the project appropriations. The university did not timely submit final reports for the projects.

Environment and Natural Resources Trust Fund

1. The University of Minnesota may have charged some ineligible costs to two projects funded by the Environment and Natural Resources Trust Fund.

Our review of project expenditures identified various costs that may not be eligible for reimbursement from the Trust Fund:

Sustainable Farming System Project

- The university paid one non-profit entity more than the contract amount. The university's contract with the entity agreed to payment of $140,000 for various project services, including outreach services. The contract anticipated that the entity's duties would involve coordination and cooperation with the other non-profits working on the project. The university paid the non-profit entity $134,933. The non-profit entity also received an additional $19,361 of project funds through one of the other non-profit entities. The total amount of project funds the non-profit received exceeded the contract amount by $14,294. We question whether the work provided through the other non-profit entity was distinctly different than the work anticipated under the original contract.
- The university paid one of the subcontractors more than the contract amount, and inadvertently charged some costs to the subsequent project appropriation. The original contract with the consultant was for $9,300. Payments to the consultant totaled $9,537, resulting in a $237 overpayment. Also, the university amended the contract with the consultant to allow the consultant to work beyond the June 30, 1999 project end date because the university expanded the scope of the contract and the consultant required additional time to perform "economic analysis for 1998". The university inadvertently charged $2,805 for this additional work to the fiscal year 2000-2001 LCMR appropriation. The university corrected this error in July 2000 by charging the costs to another funding source.

Crop Management to Minimize Pesticide Inputs Project

- The university did not obtain prior approval from the LCMR when it incurred airfare and other intercontinental travel costs totaling $1,929. Although there is no written requirement, LCMR staff told the auditors that they required prior approval for out-of-state travel.
- The university purchased $1,684 of supplies from June 28 through June 30, 1999. It is unlikely that the university used these supplies prior to June 30, 1999, which was the end date of the project.
- The university paid $31 for the review of a student thesis that had no direct benefit to the project.

The university also did not request approval for a budgetary change in the Crop Management to Minimize Pesticide Inputs project. The university budgeted $68,090 for supplies and expenses. Actual expenditures for this budget category totaled $73,919 - a nine percent increase over budget. LCMR required prior approval for any significant budget variances.

Recommendations

- *The university should work with the LCMR to determine whether the costs charged to these projects are eligible for reimbursement.*
- *The university should obtain prior approval for significant budgetary changes.*

2. The University of Minnesota did not submit final project reports in a timely manner.

The University of Minnesota did not timely submit final expenditure and work program reports to the LCMR. The university's Notice of Grant or Contract Award Letter required the project managers to submit work plans on certain dates throughout the project period and final work program reports by June 30, 1999. It also stated that the university's Department of Sponsored Financial Reporting would provide final cumulative expenditure reports. The university timely submitted the work plan reports during the project period, but did not submit the final work program and cumulative expenditure reports in a timely manner.

The university did not submit the final work program report for the Sustainable Farming project until March 30, 2000, nine months after the end date of the project. The university did not submit the cumulative expenditure report showing total expenditures for the program until April 17, 2000. The cumulative expenditure report indicated that the university had not spent all of the $560,000 appropriation on the project and owed LCMR a refund of $2,258. (See Table 2-1.) The university returned the unspent trust funds to the state in June 2000.

The university also had not submitted the final cumulative expenditure report for the Crop Management project to the LCMR as of June 2000, a year after the end of the project. We had to request this report from the university during the audit. We reviewed the report and determined that the university had not spent all of the $300,000 appropriation and owed LCMR a refund of $2,222. The LCMR was not aware that it was due a refund.

The university should timely submit reports. The timely submission of required reports would permit the LCMR to review the results of the project sooner.

Recommendation

- *The University of Minnesota should submit the required reports to the LCMR in a timely manner.*

Chapter 3. Department of Natural Resources

Chapter Conclusions

Except for the instance where it purchased equipment after the project period, the Department of Natural Resources' expenditures of trust fund appropriations complied with statutory provisions and other significant finance-related legal provisions and within the authorized period.

The Department of Natural Resources did not provide sufficient oversight for one subrecipient of trust fund monies.

The Department of Natural Resources (DNR) received 29 appropriations totaling $17,012,000 from the Environment Trust Fund for the 1998–1999 biennium. In some cases, LCMR appropriated the funds to DNR for the agency to do the project itself. In other cases, DNR was the pass-through agency responsible for monitoring the project and making payments to the subrecipients. We tested seven projects with appropriations totaling $10,547,000. Expenditures for these projects through June 30, 1999, totaled $10,408,513. Table 3-1 identifies the projects we tested.

Table 3-1
Environment Trust Fund Appropriations
DNR Appropriations Tested

Project	Appropriation Amount	Type
State Park and Recreation Area Acquisition, Development, Betterment, and Rehabilitation	$3,500,000	Direct
Minnesota County Biological Survey	1,200,000	Direct
RIM-Accelerate Fisheries Acquisition	567,000	Direct
RIM-Critical Habitat Acquisition and Enhancement	630,000	Direct
Metropolitan Regional Park System	3,500,000	Pass-through
Partners in Accessible Recreation and Environment Responsibility	550,000	Pass-through
Phalen Area Wetland Restoration-Phase II	600,000	Pass-through

Source: Minnesota Accounting and Procurement System.

Environment and Natural Resources Trust Fund

Audit Objectives and Methodology

Our review focused on the following objectives:

- Did DNR's expenditures comply with significant finance-related legal provisions and occur within the authorized period?

- Did DNR provide sufficient oversight of subrecipients to determine compliance with agreement provisions?

To answer these questions, we made inquiries of DNR staff to gain an understanding of the internal control structure over project expenditures. We tested expenditures made by DNR from direct appropriations the agency received to ensure that DNR complied with applicable finance-related legal provisions. We also tested expenditures made by the agency on pass-through appropriations to determine whether DNR was effectively monitoring subrecipients to ensure compliance with finance-related legal provisions.

Conclusion

Except for the instance where it purchased equipment after the project period, the Department of Natural Resources' expenditures of trust fund appropriations complied with statutory provisions and other significant finance-related legal provisions and within the authorized period.

The Department of Natural Resources did not provide sufficient oversight for one subrecipient of trust fund monies.

3. DNR purchased equipment after the end date of a project.

DNR used $6,296 of a trust fund appropriation to purchase equipment after the end date of the Critical Habitat Acquisition and Enhancement project. DNR purchased equipment in August 1999, although the appropriation for the project ended on June 30, 1999. The appropriation law and the approved work program for the project indicated that the project was to completed by June 30, 1999. LCMR does not allow recipients to incur expenditures after the end of the project except with an LCMR approved extension. DNR did not receive an extension for this project.

Recommendation

- *DNR should reimburse the Environment and Natural Resources Trust Fund $6,296 for the expenditures made after the project end date.*

4. The Department of Natural Resources did not adequately monitor a subrecipient.

The Department of Natural Resources did not adequately monitor a pass-through appropriation to the subrecipient who conducted the Partners in Accessible Recreation and Environment

Responsibility project. The subrecipient was a non-profit organization that educates the public about wilderness experiences. The subrecipient's project focused on expanding wilderness experiences for handicapped people. The subrecipient received $550,000 from the trust fund to provide outreach seminars. The subrecipient worked with another non-profit organization to provide the project services.

The subrecipient based its original work plan budget on a percentage of its operating costs. It estimated that the project would require 14 percent of its resources, so it budgeted 14 percent of various operating costs for the project. The subrecipient did not inform the LCMR that it had estimated its budget in this way. The request for proposal (RFP) and the project agreement both stated that “Eligible costs shall be those costs directly incurred by the recipient in the actual conduct of the project, that are solely related to and necessary for the completion of the project.” The subrecipient supported its use of the funds by claiming the same percentage against actual operating costs, stating that this project's duties were so interrelated with its other educational efforts that it could not isolate costs specifically associated with the project. While determining project costs as a percentage of operating costs may be the best way to claim reimbursement in some cases, LCMR required prior notice of this method.

DNR did not discover that the subrecipient had not based its invoices on actual costs because the department paid the appropriation to the subrecipient in eight quarterly payments of $68,750. DNR's contract with the subrecipient required that it provide DNR with evidence that it had satisfactorily completed a portion of the deliverable product and that it claimed reimbursement for the related expenses. DNR stated that it was in contact with the subrecipient about the progress of the project. However, the quarterly invoices did not itemize the costs incurred to date. DNR did not request further support for the payments and could not, based on the invoice, determine whether the subrecipient had incurred costs and whether those costs were allowable under the agreement.

The support for project costs that the subrecipient provided our auditors showed that some of the allocated costs were not eligible for reimbursement under the agreement. For example, the subrecipient allocated $12,591 for rent, an administrative overhead type of expense that LCMR does not usually allow. The subrecipient's recap of its expenditures also overstated its payments to the other non-profit organization by $34,375. The subrecipient stated that it had still appropriately spent all the funds because its actual program costs had been higher than the 14 percent they used in the allocation.

Similarly to the way that it received funds from DNR, the subrecipient passed $275,000 through to the other non-profit organization in eight equal payments and did not determine whether the organization's costs were eligible for reimbursement. The other non-profit organization provided the auditors with support for its expenditures. The documents included ineligible costs of $42,830 described as administration overhead and $5,670 of building repair and maintenance. The other non-profit organization also had not spent $278 of the $275,000 it had received from the subrecipient.

Table 3-2 itemizes ineligible costs that the subrecipient and the other non-profit organization included as project costs.

Table 3-2
LCMR Appropriation to Subrecipient
Potential Ineligible Costs

Subrecipient's Total Project Costs		**$576,828**
Less Costs Not Eligible for Reimbursement		
Subrecipient - Rent Allocation	$12,591	
Subrecipient - Extra Payment to Other Non-Profit	34,375	
Other Non-Profit - Administrative Overhead	42,830	
Other Non-Profit - Building Repair and Maintenance	5,670	
Other Non-Profit - Unspent Funds	278	
Total Potential Ineligible Costs		**95,744**
Eligible Project Costs		$481,084
Total Appropriation		550,000
Potential Project Overpayment		**$ 68,916**

Source: Records provided by subrecipient and the other nonprofit organization.

When DNR passes funds through to a subrecipient, it has the responsibility to monitor, on the state's behalf, the progress of the project and the appropriateness of project expenditures. DNR should have only reimbursed the subrecipient for costs incurred directly for the benefit of the project and should have ensured that funds passed through to the other non-profit also met LCMR requirements.

Recommendations

- *DNR should determine the extent of ineligible costs charged to this project and seek reimbursement from the subrecipient.*

- *DNR should establish a process to review actual costs for propriety prior to making payments to subrecipients.*

Status of Prior Audit Issues
As of August 29, 2000

Most Recent Audit

Legislative Audit Report 97-49, issued in September 1997, covered the period from July 1, 1993 through February 28, 1997. The scope of the audit included selected Environment and Natural Resources Trust Fund appropriations for fiscal years 1994 through 1996. The auditors tested project activity at the Department of Natural Resources, the Department of Children, Families & Learning, the Office of Environmental Assistance, and the Pollution Control Agency.

The report included three written issues. Two of the issues related to indirect costs that the Science Museum of Minnesota charged to projects through the Department of Children, Families & Learning. The third issue concerned rent that the Pollution Control Agency charged to a project. As we recommended, the Science Museum of Minnesota and the Pollution Control Agency worked with the LCMR to determine the propriety of the costs charged to the projects.

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 the metropolitan agencies, or the State Agricultural Society, the state constitutional officers, or the judicial branch.

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October 4, 2000

James Nobles
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Re: Environment and Natural Resources Trust Fund Audit

Dear Mr. Nobles:

Thank you for the opportunity to respond to the Office of Legislative Auditor's report on Environment and Natural Resources Trust Fund projects. We are pleased to provide you with the following responses to the audit findings and recommendations.

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Finding # 1 - The University of Minnesota may have charged some ineligible costs to two projects funded by the Environment and Natural Resources Trust Fund.

<u>*Recommendations*</u>

- *The university should work with the LCMR to determine whether the costs charged to these projects are eligible for reimbursement.*

<u>University of Minnesota Response:</u>

<u>Sustainable Farming System project</u>:

- The contract payments to the non-profit entity were for the outreach and teambuilding components of the project. The workplan approved by the LCMR stated that funds may need to be reallocated between organizations if necessary to successfully accomplish the objectives. The costs noted in the audit finding represent those reallocations. The project directly benefited from the costs.
- As noted in the finding, the University mistakenly charged some project costs to another LCMR appropriation. The University subsequently corrected the mistake,

and the Sustainable Farming System project was reimbursed from other University (non-LCMR) funds.

<u>Crop Management project</u>:

- As noted in the audit finding, the LCMR does not have a written policy requiring pre-approval of out-of-state travel. The finding is based on an LCMR practice that was communicated to the University by the OLA auditors at the time of the audit. Because no written policy exists and the University was unaware of the LCMR's practice, and the costs directly benefited the project, we believe that these costs are allowable to the project. To prevent this from happening in the future the University will work with the LCMR to identify the situations in which prior approval is required, and communicate them to other faculty who manage LCMR projects.
- All supplies and expenses charged against the LCMR grant were purchased during the timeframe of the grant. The University believes these costs were allowable and were incurred for the benefit of the project. The supplies purchased during the last several days were used to perform additional testing to substantiate and validate the results obtained in testing performed during the earlier stages of the LCMR project.
- The questioned cost of $31 was for expenses associated with the visit of one of the project's Principal Investigators, who is located at the University's Grand Rapids Research and Outreach Center, to the Saint Paul campus to discuss the LCMR research effort with campus personnel.

The University will work with the LCMR to provide assurance that the expenditures of the Environment and Natural Resources Trust Fund were in compliance with the approved workplans and the applicable statutory provisions.

- *The university should obtain prior approval for significant budgetary changes.*

<u>University of Minnesota response:</u>
The University of Minnesota does not have a written requirement from the LCMR regarding budget variances or restrictions on rebudgeting. In the absence of such documentation, the University used a standard of 10% per agency category as a guide, which is consistent with many federal agencies' requirements. The University will work with the LCMR to further define the level at which prior approval is required and implement appropriate processes to ensure compliance.

Finding #2 - The University of Minnesota did not submit final project reports in a timely manner.

<u>Recommendation</u>

- *The University of Minnesota should submit the required reports to the LCMR in a timely manner.*

University of Minnesota response:
The University of Minnesota agrees that the final expenditure reports were not submitted according to the terms of the agreement. In order to ensure future compliance, the Department of Sponsored Financial Reporting has centralized the financial reporting responsibility for all LCMR projects with a single individual and has redirected resources to provide additional oversight of the process. These, along with other process improvements the University is currently implementing within the department, will ensure compliance with agency reporting requirements and will also ensure that the LCMR is made aware of refunds in a timely manner.

* * *

We look forward to working with LCMR staff to address the recommendations and our responses. If you have any questions, please do not hesitate to contact me.

Sincerely,

/s/ Michael D. Volna

Michael D. Volna, CPA
Interim Controller

Cc: Beverly Durgan, Associate Dean for Research & Outreach, College of Agricultural, Food and Environmental Sciences
Helene Murray, Coordinator, Minnesota Institute for Sustainable Agriculture
Linda Kinkel, Associate Professor, Department of Plant Pathology
Joan Donaldson, Director, Sponsored Financial Reporting

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Minnesota Department of Natural Resources
OFFICE OF THE COMMISSIONER
500 Lafayette Road
St. Paul, Minnesota 55155-4037

September 27, 2000

Mr. James R. Nobles
Office of the Legislative Auditor
1st Floor Centennial Building
658 Cedar St.
St. Paul, MN 55155

Dear Mr. Nobles:

Thank you for the opportunity to respond to the audit of the Department of Natural Resources' (DNR) appropriations from the Environmental and Natural Resources Trust Fund for the period of July 1, 1997 through June 30, 1999. We appreciate the professional manner in which your staff conducted this audit. We have taken steps to rectify any errors and improve our processes where recommended.

You provide one recommendation on appropriations expended directly by DNR. You provide two recommendations regarding a pass through grant administered by DNR. These recommendations are listed below, followed by a short description of the situation and our actions to address the recommendations.

Regarding appropriations expended directly by DNR:

Recommendation:

DNR should reimburse the Environmental and Natural Resources Trust Fund $6,296 for the expenditures made after the project end date.

This recommendation is in regard to an equipment purchase made by the non-game program in an account established for a project in the approved work program for the Critical Habitat Match program. The expenditure in question was a purchase of an all-terrain vehicle necessary for our Karner blue butterfly research and management. In this case, the purchase was erroneously coded to this account by a temporary employee. We agree that this expenditure should have been coded to another account and are taking steps to repay the trust fund.

Regarding pass through grants administered by DNR:

The following two issues arose in the examination of an appropriation to DNR for a grant to a subrecipient to conduct the project titled Partners in Accessible Recreation and Environmental Responsibility. Since there are no funds provided by LCMR to administer pass through grants, DNR assigns these to various program leaders in the divisions and bureaus. These duties amount to an unfunded mandate and are added to an employees full time duties. The current recommendation from the LCMR to the 2001 legislature includes funds for management of pass through grants. This will improve pass through grant administration by ensuring a standardized approach, improving communication with LCMR staff, and allocating sufficient staff time for proper administration. This is the most important long term step to address the two recommendations below.

Recommendation:

DNR should establish a process to review actual costs for propriety prior to making payments to subrecipients.

This grant was assigned to an employee who had administered LCMR pass through grants to the recipient since 1991. The original LCMR grants were administered on a deliverable basis, not a reimbursable basis. A deliverable basis requires examination of results, not expenditures. For grants following 1991, LCMR changed the basis for payment from a deliverable basis to reimbursement for expenses incurred. A reimbursable basis requires examination of results and expenditures. This change was not clearly understood by the DNR administrator or the recipient. We have notified both and all payments are now made on a reimbursable basis and supported by documentation of actual costs incurred as well as results achieved.

Recommendation:

DNR should determine the extent of ineligible costs charged to this project and seek reimbursement from the subrecipient

Upon learning of the problem of failing to make payments on a reimbursable basis to this recipient, the DNR immediately sought proof of all actual acceptable expenses. DNR requested and received the assistance of LCMR staff to help explain LCMR pass through grant requirements and to judge the acceptability of the proof provided. Following two months of discussions and review of expenditures we received the attached letter from the recipient addressed to Steve Morse (Deputy Commissioner, DNR). Having jointly reviewed this letter with LCMR staff, we conclude that the recipient's expenditures support the payments made by DNR. Therefore, we will not request reimbursement from the subrecipient. They earned what they were paid.

We believe that these steps have resolved the recommendations. Thank you for your fine work.

Sincerely,

/s/ Allen Garber

Allen Garber
Commissioner

Attachments available upon request.

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