

Management Letter

Department of Natural Resources
Fiscal Year Ended June 30, 2002



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.

This document can be made available in alternative formats, such as large print, Braille, or audio tape, by calling 651-296-1727 (voice), or the Minnesota Relay Service at 651-297-5353 or 1-800-627-3529.

All OLA reports are available at our Web Site: <http://www.auditor.leg.state.mn.us>

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

Department of Natural Resources

Table of Contents

	Page
Report Summary	1
Management Letter	2
Status of Prior Audit Issues	6
Department of Natural Resources Response	7

Audit Participation

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

Claudia Gudvangen, CPA	Deputy Legislative Auditor
Tom Donahue, CPA	Audit Manager
Ellen Sibley, CPA	Auditor-in-Charge
Alan Sasse, CPA	Senior Auditor

Exit Conference

The findings and recommendations in this report were discussed with the following staff of the Department of Natural Resources at an exit conference held on March 12, 2003:

Gene Merriam	Commissioner
Paul Glander	Fish/Wildlife, Federal Aid Coordinator
Lori Caspers	Fish/Wildlife, ECO
Doug Julin	Trail and Waterway, Business Manager
Tim Mitchell	Trail and Waterway, Grants Specialist
Mary Jane Davis	OMB, Federal Aid Coordinator
Jerry Hampel	OMB, Business Services Manager
Lyle Mueller	OMB, Financial Reporting

Report Summary

Key Findings and Recommendations:

- The Department of Natural Resources was unable to identify land and equipment purchases reimbursed by the sport fish and wildlife programs in fiscal year 2002. We recommended that the department develop and maintain an accurate and complete listing of lands and equipment purchased with program funds, on a fiscal year basis, and to conduct a physical inventory of equipment every two years. (Finding 1, page 3)
- The Department of Natural Resources reimbursed subgrantees for costs incurred prior to the effective date of the grant agreement. We recommended that the department ensure that project costs are not incurred prior to the date the grant agreement is fully executed. (Finding 2, page 4)

Management letters address internal control weaknesses and noncompliance issues found during our annual audit of the state's financial statements and federally funded programs. The scope of work in individual agencies is limited. During the fiscal year 2002 audit, our work at the Department of Natural Resources focused on licenses and fee revenues. We also reviewed three federally funded programs administered by the department to determine whether the department complied with certain federal requirements. The department's response is included in the report.



Senator Ann H. Rest, Chair
 Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Gene Merriam, Commissioner
 Department of Natural Resources

We have performed certain audit procedures at the Department of Natural Resources as part of our audit of the financial statements of the State of Minnesota as of and for the year ended June 30, 2002. The scope of our audit work at the Department of Natural Resources included license and fee revenues, which totaled approximately \$79.7 million. We performed certain audit procedures as part of our objective to obtain reasonable assurance about whether the State of Minnesota’s financial statements for the year ended June 30, 2002, were free of material misstatement. We emphasize that this has not been a comprehensive audit of the Department of Natural Resources.

We also have audited certain federal financial assistance programs as part of our audit of the state’s compliance with the requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement*. Table 1 identifies the State of Minnesota’s major federal programs administered by the Department of Natural Resources. We performed certain audit procedures on these programs as part of our objective to obtain reasonable assurance about whether the State of Minnesota complied with the types of requirements that are applicable to each of its major federal programs.

Table 1
Major Federal Programs Administered by the
Department of Natural Resources
Fiscal Year 2002
(in thousands)

<u>CFDA #</u>	<u>Program Name</u>	<u>Federal</u>
	Fish and Wildlife Cluster:	
15.605	Sport Fish Restoration	\$10,160,279
15.611	Wildlife Restoration	<u>6,616,630</u>
	Fish and Wildlife Cluster Total	<u>\$16,776,909</u>
20.219	Recreational Trails	\$ 593,689

Source: *State of Minnesota Financial and Compliance Report on Federally Assisted Programs* for fiscal year 2002.

Department of Natural Resources

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Conclusions

Our December 6, 2002, report included an unqualified opinion on the State of Minnesota's basic financial statements for fiscal year 2002. In accordance with *Government Auditing Standards*, we also issued our report, dated December 6, 2002, on our consideration of the State of Minnesota's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. At a later date, we will issue our report on compliance with requirements applicable to each major federal program and internal control over compliance in accordance with OMB Circular A-133.

As a result of our procedures, we identified the following weakness in internal control over federal compliance at the Department of Natural Resources.

1. The Department of Natural Resources was unable to identify land and equipment purchases reimbursed by the sport fish and wildlife programs on a fiscal year basis.

The department was unable to track reimbursements of land and equipment from the sport fish and wildlife restoration programs on a fiscal year basis. The department records payment information into the state's accounting system when project expenses are paid. However, as reimbursements for expenditures were received, the department did not record the detail of the type of expenditure that was reimbursed. As a result, we could not link the reimbursements to a specific expenditure. For example, we noted the following:

- The department was unable to provide a complete listing of lands reimbursed with sport fish and wildlife restoration funds in fiscal year 2002. Although the department has a land management database of land acquired, it is currently unable to identify what land was reimbursed with federal program funds. As a result, we could not determine the amount of land purchases reimbursed with federal funds, or whether the department complied with federal regulations.
- The department was unable to provide a listing of equipment that was reimbursed with sport fish and wildlife restoration funds in fiscal year 2002. The department indicated that they did not request reimbursement for equipment greater than \$5,000. Federal program requirements provide that state agencies shall use, manage, and dispose of equipment acquired under a federal grant in accordance with state laws and procedures. Currently, state policy directs agencies to inventory all non-expendable property of \$2,000 or more and all sensitive items as established by agency policy. Also, a complete physical inventory is required every two years. The department indicated that it has not conducted a physical inventory in the last two years.

Department of Natural Resources

Recommendations

- *The department should develop and maintain an accurate and complete listing of lands reimbursed with sport fish and wildlife restoration funds on a fiscal year basis.*
- *The department should identify equipment in excess of \$2,000 reimbursed on a fiscal year basis with sport fish and wildlife restoration funds. The department should also conduct a physical inventory of its equipment inventory every two years.*

2. The department reimbursed subgrantees for costs incurred prior to the effective date of the grant agreement.

The department reimbursed three subgrantees a total of \$88,824 in federal recreational trails program funds for costs incurred prior to the effective date of the grant agreements. For 3 of 15 transactions tested, we noted that the department paid the subgrantees for costs incurred prior to the effective date of the grant agreement. One reimbursement for \$22,410 paid for costs incurred on November 30, 2001, but the grant agreement was not signed until March 2, 2002. Another reimbursement for \$26,500 paid for costs incurred on February 13, 2002; however, the grant agreement was not signed until February 20, 2002. Finally, a reimbursement for \$39,914 was paid for costs incurred on or prior to January 31, 2002, but the grant agreement was not signed until February 20, 2002.

Procurement of property and services under the recreational trails program is regulated under 49 CFR 18.36 (a). It provides that, "When procuring property and services under a grant, a State will follow the same policies and procedures it uses for procurements from its non-federal funds." State law in part, through Minn. Stat. Section 16C.05, provides that, "A contract is not valid and the state is not bound by it unless it has first been executed by the head of the agency or a delegate..."

The grant agreements we reviewed appropriately provided that any costs made before the agreement was effective were non-reimbursable costs. The grant agreements specified that the effective date of the agreement was the date executed by the DNR. In addition, the department advised its grantees that, "A fully signed contract must be established prior to incurring any costs for the project in order to be eligible for reimbursement." However, the department did not follow the provisions of the law as provided in its grant agreements.

Recommendation

- *The department should ensure that project costs are not incurred prior to the date the grant agreement is fully executed (signed).*

Department of Natural Resources

This report is intended for the information of the Legislative Audit Commission and the management of the Department of Natural Resources. This restriction is not intended to limit the distribution of this report, which was released as a public document on March 20, 2003.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: January 2, 2003

Report Signed On: March 18, 2003

Status of Prior Audit Issues As of January 2, 2003

Fiscal Year 2001 Statewide/Single Audit

We examined the department's activities and programs material to the *State of Minnesota's Comprehensive Annual Financial Report* for the fiscal year ended June 30, 2001. The purpose of the audit was to render an opinion on the State of Minnesota's financial statements for fiscal year 2001. We issued an unqualified opinion on the *State of Minnesota's Comprehensive Annual Financial Report* for the year ended June 30, 2001. We identified one financial statement finding in which the department did not properly record certain expenditure transactions in the state's accounting system. This finding continues to be an issue and was reported on for fiscal year 2002 in our **Legislative Audit Report 02-65** Finding 12.

Most Recent Financial-Related Audit

Legislative Audit Report 02-65, issued in October 2002, covered the period from July 1, 1999, through June 30, 2002. The audit scope included various revenue and expenditure areas, including payroll, license center revenues and cost allocations, tree nursery revenues and expenditures, and fleet management revenues and expenditures. The report contained 17 findings. Several findings dealt with the license center revenues and are included in our schedule of financial statement audit findings in the 2002 Single Audit Report. Several findings related to the tree nursery program, and several findings were raised in the fleet management program. These findings were not relevant to our current audit and, as a result, we did not pursue the status as part of this audit.

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.

Minnesota Department of Natural Resources
OFFICE OF THE COMMISSIONER

500 Lafayette Road
St. Paul, Minnesota 55155-4037

March 18, 2003

James Nobles
Office of Legislative Auditor
140 Centennial Office Building
St. Paul, MN 55155

Dear Mr. Nobles:

Thank you for the opportunity to respond to the findings of the financial audit of selected federal programs of the Department of Natural Resources for the year ended June 30, 2002. This letter has been prepared in response to the draft audit report as of March 13, 2003.

Audit Finding #1. The Department of Natural Resources was unable to identify land and equipment purchases reimbursed by the sport fish and wildlife programs on a fiscal year basis.

Recommendations

- *The department should develop and maintain an accurate and complete listing of lands reimbursed with sport fish and wildlife restoration funds on a fiscal year basis.*
- *The department should identify equipment in excess of \$2,000 reimbursed on a fiscal year basis with sport fish and wildlife restoration funds. The department should also conduct a physical inventory of its equipment inventory every two years.*

The Department concurs with the above audit recommendation relating to its database of state lands. The agency agrees to implement changes to its input codes such that land transactions submitted for federal reimbursement can be retrieved on a fiscal year basis.

The Department keeps accurate records of all land purchases submitted for federal reimbursement. Those reimbursement records, however, are based on federal project numbers (segments) of specific grants and reports on reimbursements can most readily be generated on this basis. The federal aid coordinator for the DNR divisions of Fish, Wildlife and Ecological Services maintains the database. Information about reimbursements on a fiscal year basis can be constructed by reviewing dated

reimbursement requests and linking the segment numbers from the reimbursement requests to the segment numbers in the federal aid coordinator's database. However, the changes prompted by this audit finding will allow the Department to more readily retrieve reimbursement information on a fiscal year basis.

The Department will comply with the audit recommendation to denote equipment that has been submitted for federal reimbursement on a fiscal year basis. The department's database has the ability to track a federal interest in its acquired fixed assets, and this capability has been used to date for selected federal programs. The department's database of fixed assets includes equipment with an acquisition cost of \$2,000 or more and agency-designated sensitive items as required by State of Minnesota procurement and inventory management policies and procedures. The changes prompted by this audit finding will allow the Department to more readily retrieve federal reimbursements for equipment fixed assets on a fiscal year basis.

The Department further agrees with your recommendation that the agency complete a physical inventory of fixed assets as required by current state policy and procedure. The Facilities and Operations Support bureau, the unit responsible for agency procurement and maintaining DNR fixed asset records, will ensure that a complete physical inventory is completed by June 30, 2003.

Audit Finding #2. The department reimbursed subgrantees for costs incurred prior to the effective date of the grant agreement.

Recommendation

- *The department should ensure that project costs are not incurred prior to the date the grant agreement is fully executed (signed).*

The Department agrees with the audit's grant agreement findings as written in that the department did not follow the provisions in the contract. Contract provision 3.2.1 (contract A29033 between the DNR and St. Louis County) describes an ineligible cost as "Any expenditure before this Agreement is effective." Provision 8.1 defines effective as "This Agreement shall become legally effective upon such date as it is executed by the Department of Natural Resources."

In response to this specific finding the Department will endeavor to ensure that contracts are implemented according to the provisions contained in the agreement.

The Department does not agree with the audit's statement of recommendation that project costs incurred prior to the date of the executed agreement are ineligible costs for reimbursement. The agreement between the Department of Natural Resources and its subgrantee is governed by 49 CFR 18.37, an administrative regulation under the Recreational Trails Program. Thus, the Department is required meet all federal and state

requirements for subgrant agreements. This means all federal requirements, including the “period of availability of funds” as defined in 49 CFR 18.23 should be stated in the subgrant agreement. The period of availability of funds, including the start date, is found in the federal award document, stated in the federal and state agreement, and/or the federal guidance documents, e.g. grant manuals.

We do not believe state law prohibits the reimbursement of expenditures allowed under federal law that are incurred prior to a fully executed grant agreement so long as the reimbursement occurs after the contract is fully executed.

The Department will ensure the necessary language has been included in all state and local subgrant agreements. That language will clearly define the allowable period in which expenditures incurred are eligible for reimbursement and that the Department will not process eligible reimbursements until after the contract has been fully executed.

The Department thanks the Office of the Legislative Auditor for its audit of selected federal programs, and appreciates the opportunity to respond to the recommendations.

If further follow-up to the audit is required feel free to contact me or my office for assistance.

Sincerely,

/s/ Gene Merriam

Gene Merriam
Commissioner