



Department of Natural Resources

Internal Controls and Compliance Audit

July 2015 through June 2017

August 30, 2018
REPORT 18-12

Financial Audit Division

OFFICE OF THE LEGISLATIVE AUDITOR

STATE OF MINNESOTA

Financial Audit Division

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OFFICE OF THE LEGISLATIVE AUDITOR

STATE OF MINNESOTA • James Nobles, Legislative Auditor

August 30, 2018

Senator Mary Kiffmeyer, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Thomas Landwehr, Commissioner
Department of Natural Resources

This report presents the results of our internal controls and compliance audit of the selected activities of the Department of Natural Resources for the period July 2015 through June 2017. The objectives of this audit were to determine if the department had adequate internal controls over selected administrative cost allocations and whether the department complied with significant finance-related legal requirements.

This audit was conducted by Sonya Johnson, CPA, CFE (Audit Director); Emily Wiant (Auditor-in-Charge); Kevin Herrick, CISA (Senior Auditor); Paul Rehschuh (Senior Auditor); and Kris Schutta (Senior Auditor).

We received the full cooperation of the Department of Natural Resources staff while performing this audit.

Sincerely,

James R. Nobles
Legislative Auditor

Christopher P. Buse
Deputy Legislative Auditor



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Report Summary

The Department of Natural Resources (DNR) is responsible for conserving and managing the state's natural resources. The department provides outdoor recreation opportunities for Minnesota citizens and commercial uses of natural resources for businesses. Governor Mark Dayton appointed Thomas Landwehr to serve as the DNR commissioner in January 2011.

The Office of the Legislative Auditor conducted this selected scope audit to determine whether the department had adequate internal controls and complied with significant finance-related legal requirements. The audit scope included the processes for allocating certain administrative costs to DNR divisions. The period under examination went from July 2015 through June 2017.

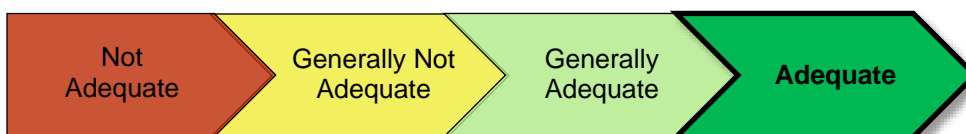
Conclusion

The Department of Natural Resources complied with the significant finance-related legal requirements we tested and had adequate internal controls over its internal process for allocating department shared services and leadership costs to its divisions.

Legal Compliance



Internal Controls

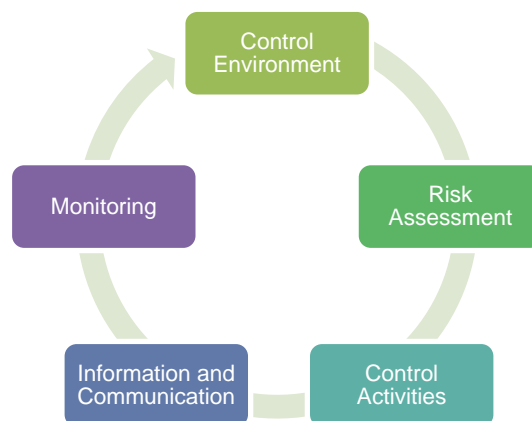




Audit Overview

This report presents the results of an internal controls and compliance audit of selected activities in the Department of Natural Resources (DNR). Management is responsible for establishing internal controls to safeguard assets and ensure compliance with applicable laws, regulations, and state policies.

A strong system of internal controls begins with management's philosophy, operating style, and commitment to ethical values. It also includes processes to continuously assess risks and implement control activities to mitigate risks. A successful internal controls system includes iterative processes to monitor and communicate the effectiveness of control activities.



Agency Overview

DNR operates under *Minnesota Statutes* 2017, Chapter 84. DNR is a complex and diverse agency that helps protect and manage land, water, fish, and wildlife in Minnesota. The agency also provides citizens with access to outdoor recreation opportunities throughout the state.

DNR supports its highly diverse mission with a complex financial structure. For the biennium ending in Fiscal Year 2017, the agency had a budget that totaled over \$1.1 billion. DNR accounts for its budget in 50 funds in the State of Minnesota's accounting system.

DNR offers its services through seven divisions. Six of these divisions offer citizen-facing services, while the Operational Services Division provides centralized support to the agency itself. Exhibit 1 provides a description of each DNR division.

Exhibit 1: Department of Natural Resources Divisions



Parks and Trails

Creates park, trail, and water recreation experiences



Lands and Minerals

Provides expertise in law, science, geology, engineering, industry, and real estate



Fish and Wildlife

Helps citizens explore and enjoy Minnesota's fishing and wildlife habitats



Forestry

Keeps Minnesota's forests and trees growing strong



Enforcement

Helps ensure compliance with conservation laws



Ecological and Water Resources

Ensures healthy lands and waters



Operational Services

Provides central support services to all other DNR divisions

SOURCE: Information published on the Department of Natural Resources' website.

Administrative Cost Overview

DNR allocates administrative costs to its divisions using a variety of allocation methodologies. For example, in Fiscal Year 2017, the department allocated about \$69 million to its divisions. For some cost pools, the primary allocation factor was each division's percentage of the overall staffing or budget. For other cost pools, such as fleet services, the driving allocation factor was historical use of the service. Exhibit 2 provides an overview of the total administrative cost structure for DNR, along with its billings and allocation methodology.

Exhibit 2: Administrative Cost Categories for Fiscal Year 2017

	Shared Services	Leadership Services	Legal	Fleet	Other Agency Costs
Cost Pool Components	Operational Services Division costs, including accounting, human resources, internal audit, planning, safety, and communications	Commissioner's Office, Regional Office Directors and supporting staff	Attorney General's Office negotiated services, in-house legal counsel, and contracted legal services	Vehicles and supporting equipment, such as radios, cell phones, and computers; also included are all-terrain vehicles and snowmobiles	Information technology, statewide computer systems and indirect costs, unemployment insurance, workers' compensation, facilities, and real estate
Internal Billings	\$15,008,536	\$2,785,090	\$1,038,000	\$23,155,138	\$26,735,027
Percent of Total Internal Billings	22%	4%	2%	34%	38%
Allocation Methodology Basis	Index consisting of a combination of full-time equivalents and budget	Consolidated index consisting of a combination of a human resources index and fiscal activity index	Based on a prior three-year average of Attorney General billings	Historical usage and other factors	Various factors, depending on the specific state agency cost

SOURCE: State of Minnesota's accounting system data and information from the Department of Natural Resources.

Administrative Cost Governance

The department has a Shared Services Governance Board, consisting of the deputy commissioner and the division directors. The board provides oversight of most administrative cost budgets and allocation methodologies. The board also reviews and makes funding recommendations for one-time initiatives. Beginning in Fiscal Year 2018, the Shared Services Governance Board also provided oversight of leadership cost allocations. Before 2018, the chief financial officer set the leadership cost budget and allocation methodology.

The Operations Services Division creates service level agreements with each division. These agreements outline the base-level services that each division will receive, along with the cost allocation for the services. If divisions require services beyond what is in the base, the Operations Services Division creates stand-alone agreements for the additional services. Finally, the Operations Services Division creates separate service level agreements for activities in the Outdoor Heritage Fund and the Environmental and Natural Resources Trust Fund.

Beginning in Fiscal Year 2016, the department simplified its methodology for allocating shared services costs. The current methodology allocates costs based on the proportion of funds appropriated for each division and the number of full-time equivalents for each division. The department allocates leadership costs to its

divisions using several fiscal and human resource indexes. The department refers to the combination of these metrics as the consolidated index.

The Operations Services Division internally bills the divisions twice a year for both shared and leadership services. The divisions are responsible for determining how to allocate these costs among the funds that they manage. The Operations Services Division provides all the divisions with information regarding funds that they can charge these costs to and those that have limits or restrictions associated with them. The Operations Services Division requires that the individual divisions certify their fund integrity and specify valid funding sources that they plan to charge their portion of shared services and leadership costs to.

Financial Activity

The department receives legislative appropriations, federal grants, and user fees. However, the Operations Services Division does not receive a General Fund appropriation for its centralized support services or leadership costs. The department internally allocates and bills these costs to the various divisions.

Total internal billings for shared services and leadership costs for the audit period are approximately \$34.5 million, as depicted in Exhibit 3.

Exhibit 3: Department of Natural Resources Shared Services and Leadership Internal Billings by Division

	2016	2017
Shared Services		
Parks and Trails	\$ 4,061,399	\$ 4,489,596
Fish and Wildlife	3,561,238	3,776,116
Forestry	2,293,918	2,620,977
Ecological and Water Resources	1,773,778	1,871,632
Enforcement	1,493,230	1,520,971
Lands and Minerals	568,772	596,768
Leadership	124,005	132,475
Total ^a	<u>\$13,876,340</u>	<u>\$15,008,535</u>
Leadership Services		
Fish and Wildlife	\$ 775,132	\$ 782,090
Parks and Trails	743,199	775,396
Forestry	408,810	438,280
Ecological and Water Resources	451,378	457,675
Enforcement	207,661	184,195
Lands and Minerals	198,910	147,454
Total	<u>\$ 2,785,090</u>	<u>\$ 2,785,090</u>

^a The difference in Shared Services billings between fiscal years 2016 and 2017 was mostly due to credits applied back to the divisions totaling \$920,000 in Fiscal Year 2016. The credits were from available funds in the Shared Services account and were reviewed by the Shared Services Governance Board who recommended that these credits be applied to Fiscal Year 2016 billings.

SOURCE: State of Minnesota's accounting system.

Audit Scope

This audit reviewed selected activities of the Department of Natural Resources for the period from fiscal years 2016 through 2017.

Shared Services and Leadership Costs

Our audit scope included a review of the department's methodology for allocating shared services and leadership costs to its divisions, excluding administrative costs related to the Outdoor Heritage Fund, Environmental and Natural Resources Trust Fund,¹ and federal funds.² We also reviewed the department's methodologies for allocating shared services and leadership costs to individual funding sources.

Audit Objective

We designed our audit to answer the following questions:

- Did the Department of Natural Resources' internal controls over its process for allocating department services provide reasonable assurance that these costs were distributed equitably?
- Did the Department of Natural Resources comply with significant finance-related legal requirements?

Audit Methodology and Criteria

To answer the audit objective questions, we interviewed staff to gain an understanding of the department's policies and procedures for allocating costs. We reviewed legal criteria in the *Laws of Minnesota* 2015, First Special Session, chapter 4, art. 3, sec. 3; *Laws of Minnesota* 2016, chapter 189, art. 3, sec. 3; *Laws of Minnesota* 2017, chapter 93, art. 1, sec. 3; and Minnesota statutes to determine any restrictions on the use of funds for administrative costs. We also analyzed accounting data to identify unusual trends or significant changes in financial operations. Finally, we examined documentation to support the department's allocation of shared services and leadership costs.

¹ The Outdoor Heritage Fund and Environmental and Natural Resource Trust Fund are constitutionally-dedicated funds. The department has a separate process for identifying and charging administrative costs to these funds.

² The department has a formal indirect cost rate agreement with the federal government. The Office of the Legislative Auditor audited the indirect cost rate agreement with the federal government for Fiscal Year 2016 as part of the 2016 Federal Single Audit. There were no findings associated with that work.

We conducted the audit in accordance with generally accepted government auditing standards.³ 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.

We assessed internal controls against the most recent edition of the internal control standards, published by the U.S. Government Accountability Office.⁴ To identify legal compliance criteria for the activity we reviewed, we examined state and federal laws, state administrative rules, state contracts, and policies and procedures established by the departments of Administration, Management and Budget, and Natural Resources.

Conclusion

The Department of Natural Resources complied with the significant finance-related legal requirements we tested and had adequate internal controls over its internal process for allocating department shared services and leadership costs to its divisions.

³ U.S. Government Accountability Office, *Government Auditing Standards*, December 2011.

⁴ Comptroller General of the United States, U.S. Government Accountability Office, *Standards for Internal Control in the Federal Government* (Washington, DC, September 2014). In September 2014, the State of Minnesota adopted these standards as its internal control framework for the executive branch.

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