Iron Range Resources and Rehabilitation Board
Selected Scope Audit

For the Period July 1, 1995, through June 30, 1998

October 1998

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Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

98-61

Centennial Office Building, Saint Paul, MN 55155 • 612/296-1727

STATE OF MINNESOTA
OFFICE OF THE LEGISLATIVE AUDITOR
JAMES R. NOBLES, LEGISLATIVE AUDITOR

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Iron Range Resources and Rehabilitation Board

Members of the Iron Range Resources and Rehabilitation Board

Mr. James Gustafson, Commissioner
Iron Range Resources and Rehabilitation Board

We have conducted a financial related audit of selected activities of the Iron Range Resources and Rehabilitation Board for the period July 1, 1995, through June 30, 1998. We emphasize that this was not a complete audit of all Iron Range Resources and Rehabilitation Board programs. Our audit scope included the taconite tax receipts and the economic loan program for the period July 1, 1997, through June 30, 1998. Our scope also included Giants Ridge and Ironworld operations for the period July 1, 1995, through June 30, 1998. Our audit objectives included reviewing internal controls over financial activities and determining compliance with laws and regulations. The following Summary highlights the audit objectives and conclusions. We discuss these issues more fully in the individual chapters of this report.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we obtain an understanding of management controls relevant to the audit. The standards also require that we design the audit to provide reasonable assurance that the Iron Range Resources and Rehabilitation Board complied with provisions of laws, regulations, contracts, and grants that are significant to the audit. Management of the Iron Range Resources and Rehabilitation Board is responsible for establishing and maintaining the internal control structure and complying with applicable laws, regulations, contracts, and grants.

We intend this report to be for the information of the Legislative Audit Commission and management of the Iron Range Resources and Rehabilitation Board. We do not, however, limit the distribution of this report, which was released as a public document on October 30, 1998.

James R. Nobles
Legislative Auditor

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: July 2, 1998

Report Signed On: October 27, 1998

1ST FLOOR SOUTH, CENTENNIAL BUILDING • 658 CEDAR STREET • ST. PAUL, MN 55155
TELEPHONE 612/296-4708 • TDD RELAY 612/297-5353 • FAX 612/296-4712 • WEB SITE http://www.auditor.leg.state.mn.us

SUMMARY

State of Minnesota
Office of the Legislative Auditor
1st Floor Centennial Building
658 Cedar Street • St. Paul, MN 55155
(651)296-1727 • FAX (651)296-4712
TDD Relay: 1-800-627-3529
email: auditor@state.mn.us
URL: http://www.auditor.leg.state.mn.us

Iron Range Resources and Rehabilitation Board

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Public Release Date: October 30, 1998 No. 98-61

Agency Background

The 1941 Legislature created the Iron Range Resources and Rehabilitation Board (IRRRB) to develop the remaining resources of the taconite tax relief area of northeastern Minnesota. The tax relief area is an area which encompasses Minnesota's three iron ranges (Cuyuna, Mesabi, and Vermilion) and covers all or portions of Cook, Lake, St. Louis (excluding Duluth), Itasca, Aitkin, and Crow Wing counties. Jim Gustafson has served as the IRRRB commissioner since June 1992.

Audit Scope and Conclusions

Our audit scope included the taconite tax receipts and the economic loan program for the period July 1, 1997, through June 30, 1998. Our scope also included Ironworld USA and Giants Ridge operations for the period July 1, 1995, through June 30, 1998. Our audit objectives included reviewing internal controls over financial activities and determining compliance with laws and regulations. This was not a complete audit of all Iron Range Resources and Rehabilitation Board programs.

IRRRB properly accounted for the receipt and deposit of taconite production taxes. IRRRB designed internal controls to provide reasonable assurance that loan receivable transactions for the Economic Loan Program were properly authorized and accurately recorded in the state's accounting records. However, IRRRB has been unable to reconcile their loan program to the state's accounting system.

IRRRB collected and appropriately deposited receipts generated from Giants Ridge and Ironworld USA operations. It also designed and implemented controls to provide reasonable assurance that it safeguarded Giants Ridge and Ironworld USA receipts and properly recorded them on the state's accounting system. IRRRB properly authorized Giants Ridge and Ironworld USA payroll and other administrative expenditures to ensure that they were made for a proper purpose and accurately recorded in the state's accounting system. IRRRB needs to ensure that Giants Ridge employees comply with statutory gift restrictions. IRRRB also needs to more closely monitor Ironworld USA's gift shop receipts.

IRRRB agreed with the findings and is taking corrective action to resolve the issues.

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Audit Participation

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

Claudia Gudvangen	Deputy Legislative Auditor
Cecile Ferkul, CPA, CISA	Audit Manager
Carl Otto, CPA, CISA	Auditor-in-Charge
Brad Falteysek	Auditor
Neal Dawson	Auditor

Exit Conference

We discussed the issues in this report with the following staff of the Iron Range Resources and Rehabilitation Board on October 19, 1998:

Jim Gustafson	Commissioner
Shawn Hooper	Deputy Commissioner
Todd Nelson	Chief Financial Officer

Chapter 1. Introduction

Aware of the economic impact of an area's dependence on a single industry, the 1941 Legislature created the Iron Range Resources and Rehabilitation Board (IRRRB) to coordinate the development of the remaining resources of the taconite tax relief area and contribute toward the vocational training and rehabilitation of the residents in northeastern Minnesota. The taconite tax relief area is an area that encompasses Minnesota's three iron ranges: Cuyuna, Mesabi, and Vermilion. It covers all or portions of Cook, Lake, St. Louis (excluding Duluth), Itasca, Aitkin, and Crow Wing counties.

The Iron Range Resources and Rehabilitation Board is composed of five state senators, five state representatives, and the commissioner of the Department of Natural Resources. The state senators and state representatives serve two-year terms. Statutes specify that a majority of the legislative appointees have to have been elected from districts in which over 50 percent of the residents resided within the taconite tax relief area.

The Governor appoints the commissioner to conduct the administrative operations of the IRRRB. Statutes designate the commissioner and other IRRRB employees as part of the executive branch of government. Mr. Jim Gustafson has served as the IRRRB commissioner since June 1992. IRRRB's administrative offices are located in Eveleth, Minnesota.

IRRRB receives most of its funding from a taconite production tax paid by area mining companies in lieu of local property taxes. IRRRB receives taconite production taxes to fund its programs and to provide reimbursements to mining companies for acquisitions and technology improvements. IRRRB maintains various accounts for the taconite production taxes. State statutes designate how the taconite production taxes are allocated into these accounts and specify how the funds can be used. The taconite production taxes and IRRRB's various accounts are further explained in Chapter 2.

IRRRB carries out many of its economic development efforts through loans and grants to businesses and local governments. In our prior audit at IRRRB, we examined its grant distribution process. See the *Status of Prior Audits* section at the end of this report for a brief recap of any issues raised. In our current audit, we limited our review of grants to determining the resolution of prior audit recommendations.

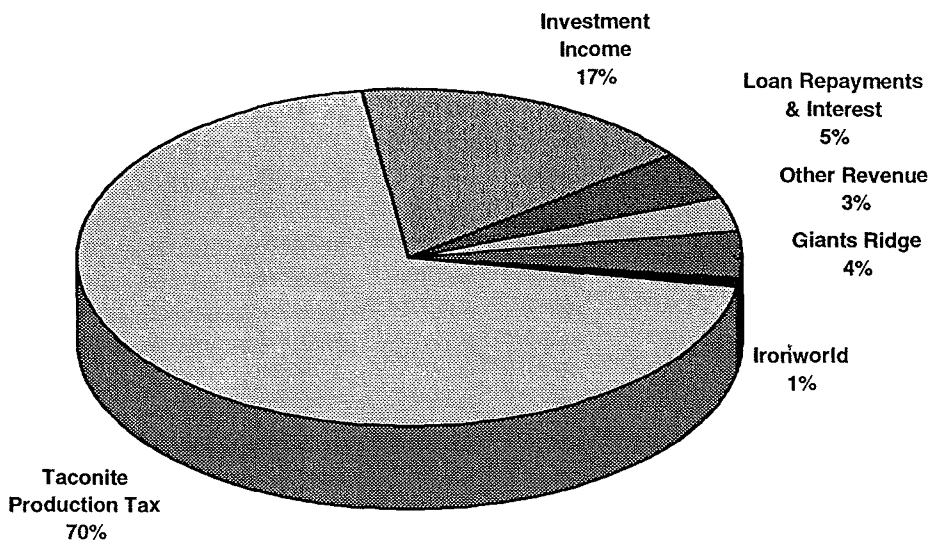
As described in Chapter 3, we examined IRRRB's internal controls to determine whether they provided reasonable assurance that loan issuances and repayments were properly authorized, calculated, and accurately reported in the accounting records, and whether IRRRB complied with material finance-related legal provisions related to loan issuances and repayments.

A unique aspect of IRRRB's operations is its ownership and management of two tourism facilities. In Chapter 4, we discuss IRRRB's golf and ski facility, the Giants Ridge Resort, located near Biwabik. In Chapter 5, we discuss IRRRB's other tourism facility, Ironworld, located in Chisholm. Ironworld is a historical theme park designed to preserve and celebrate iron range history and culture.

Iron Range Resources and Rehabilitation Board

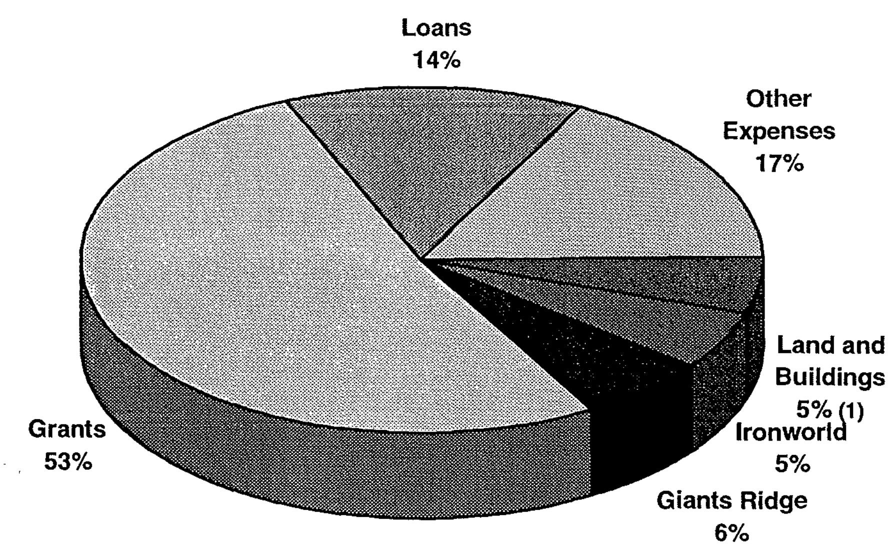
Figures 1-1 and 1-2 summarize the significant financial activity of the IRRRB for fiscal years 1996 through 1998.

Figure 1-1
Financial Sources
FY96 - FY98



Source: Minnesota Accounting and Procurement System as of June 30, 1998.

Figure 1-2
Financial Uses
FY 96 - FY 98



(1) Land and Buildings includes purchases for the Giants Ridge golf course.

Source: Minnesota Accounting and Procurement System as of June 30, 1998.

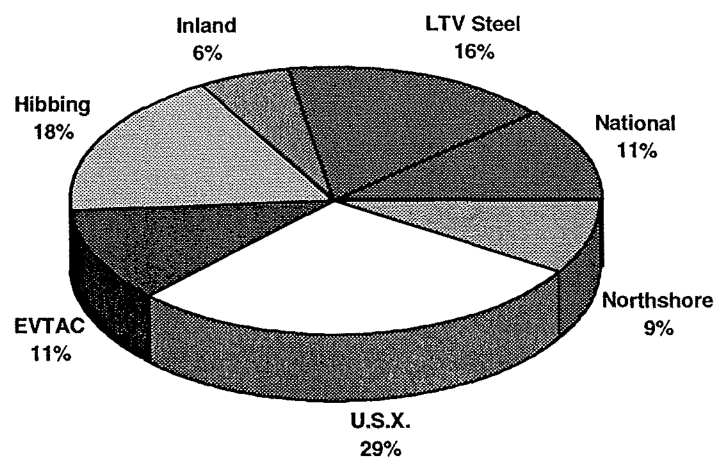
Chapter 2. Taconite Production Tax Revenue

Chapter Conclusions

The main source of IRRRB funds is a taconite production tax assessment on mining companies. We found that the IRRRB properly accounted for the receipt and deposit of taconite production taxes.

Seven mining companies in Minnesota produce 75 percent of the United States total taconite production. The taconite production tax is the largest tax these mining companies pay, and it is a major source of revenue, not only for IRRRB, but also for counties, municipalities, and school districts in the taconite relief area. For fiscal year 1998, the mining companies paid $2.141 per ton of taconite produced. The Minnesota Department of Revenue calculated and assessed the taxes, and billed the mining companies. The fiscal year 1998 assessment totaled $94,704,666, based on the mining companies' taconite production for calendar year 1997. IRRRB received $34,281,990 of this amount. Figure 2-1 shows the share of this funding borne by each of the mining companies.

Figure 2-1
Mining Companies Share of Taconite Production Tax
Fiscal Year 1998



Source: Department of Revenue billing records.

As directed by statute, IRRRB used the taconite taxes to provide operational funding, reimburse taconite companies for development efforts, maintain trust funds, and administer grants and loans to ensure the future vitality of the taconite relief area. IRRRB recorded the tax receipts on the state's accounting system into two funds, the Iron Range Resources and Rehabilitation Fund and the Northeast Minnesota Economic Protection Fund, as shown in Table 2-1.

Table 2-1
1998 Taconite Tax Receipts
Allocation to IRRRB Accounts

	Amount
Iron Range Resources and Rehabilitation Fund	
Taconite Environmental Protection Account	$15,132,715
Taconite Economic Development Account	7,444,818
IRRR Board Account	4,313,577
Hoyt Lakes Industrial Park Grant	2,094,484
Total	$28,985,594
Northeast Minnesota Economic Protection Fund	5,296,396
Total FY 1998 Taconite Production Tax Allocation	$34,281,990

Source: Minnesota Accounting and Procurement System (MAPS).

Taconite Environmental Protection Account

IRRRB deposited the largest share of the taconite production taxes into the Taconite Environmental Protection Account. The Legislature established this account to reclaim, restore, and enhance areas within the taconite relief area. IRRRB can use these funds for the following purposes:

- to research environmental problems requiring remedial action;
- to reclaim, restore, or reforest minelands;
- to fund local development projects; and
- to monitor mining employee health problems that may be attributable to the mining industry.

Taconite Economic Development Account

The Legislature created the Taconite Economic Development Account in 1992 to encourage mining companies to reinvest in their operations. IRRRB credits each mining company's account with their share of the tax. The mining companies can recover these funds for specific projects to enhance the mining industry in Minnesota. For example, mining companies could receive funds to upgrade equipment or develop mining technology.

IRRR Board Account

Taconite taxes comprised the main source of funds for the IRRR Board Account. IRRRB used these funds to pay for administrative costs, grants and loans for economic development, and to subsidize the operation of its recreational facilities (the Giants Ridge Resort and Ironworld USA). These facilities are discussed in Chapters 5 and 6.

Iron Range Resources and Rehabilitation Board

Hoyt Lakes Industrial Park Grant

The 1997 Legislature designated a grant from the taconite production tax to the city of Hoyt Lakes to establish an industrial park. The laws authorized the city to receive the portion of the 1997 taconite production tax that was attributable to the increase in the implicit price deflator. The three-cent per taxable ton increase provided the city with $2,094,484.

Northeast Minnesota Economic Protection Trust Fund

The Legislature established the Northeast Minnesota Economic Protection Trust Fund in 1977, funding it with a part of the taconite production tax. Although the Legislature has restricted the corpus of the fund until 2002, IRRRB can use the interest earnings to stimulate employment and encourage diversification of the area's economy. At June 30, 1998, the corpus balance exceeded $67 million.

Audit Objectives and Methodology

We focused our audit of the taconite production tax receipts on the following objectives:

- Did IRRRB receive the taconite production taxes assessed to the mining companies by the Department of Revenue for fiscal year 1998?
- Did IRRRB record the taxes into the appropriate accounts in accordance with the Department of Revenue's allocation?

We interviewed department personnel, performed analytical reviews, and tested the amounts received by IRRRB for accuracy of recording.

Conclusions

The Iron Range Resources and Rehabilitation Board received the taconite taxes as assessed by the Department of Revenue. IRRRB recorded the taxes in the appropriate accounts, in accordance with the Department of Revenue's allocation.

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Chapter 3. Loans

Chapter Conclusions

The IRRRB designed internal controls to provide reasonable assurance that loan receivable transactions for the Economic Loan Program were properly authorized and accurately recorded in the accounting records. For the items tested, the IRRRB complied with material finance-related legal provisions relating to loans. However, IRRRB has been unable to reconcile their loan program to the state's accounting system.

As a part of its mission to enhance the economic vitality of the taconite relief area, IRRRB administers a business loan program. As of June 30, 1998, the outstanding loan receivable balance was $31,095,288. IRRRB used interest earned by the Northeast Minnesota Economic Protection Trust Fund to finance $24,482,042 of these loans, and used the IRRR Board account for the remaining $6,613,245. Table 3-1 recaps the loan activity during fiscal year 1998.

Table 3-1
Loan Activity
Fiscal Year 1998

	IRRR Board Account	NE Minnesota Economic Protection Fund	Total
Loans Outstanding 7/1/97	$6,812,275	$22,691,523	$29,503,798
New Loans 7/1/97–6/30/98	0	3,430,623	3,430,623
Loan Repayments 7/1/97-6/30/98	(189,449)	(1,524,070)	(1,713,519)
Loan Cancellations 7/1/97-6/30/98	(9,581)	(116,034)	(125,615)
Loans Outstanding 6/30/98	$6,613,245	$24,482,042	$31,095,287

Sources: Minnesota Accounting and Procurement System and IRRRB loan cancellation and write-off data as of June 30, 1998.

The IRRRB loan program consists of both bank participation loans and direct loans to various businesses. In the bank participation loan program, IRRRB funds up to 50 percent of a project, with the remainder being funded by a bank. IRRRB and the bank sign a participation agreement, which details the responsibilities of both parties, and the understanding regarding timing and amount of repayments. A statutory formula determines the amount of interest IRRRB charges on its portion of the loan. The interest rate is determined by taking the lessor of eight percent or the rate of a comparable United States government maturity less three percentage points. The bank negotiates directly with the loan applicant for the interest rate it charges. IRRRB relied on the banks to determine appropriate levels of loan collateral and to perfect any liens.

Iron Range Resources and Rehabilitation Board

In a direct loan, IRRRB disburses the loan directly to businesses without any bank involvement. In those cases, IRRRB takes responsibility for determining the level of collateral and perfecting any liens.

Loan Issuance

During fiscal year 1998, IRRRB disbursed nine participation loans and five direct loans totaling $3,430,623. IRRRB funded all the loans with the interest earnings of the Northeast Minnesota Economic Protection Fund. Table 3-2 shows the loan recipients and amounts.

Table 3-2
Loans Issued During Fiscal Year 1998

Project Name	Loan Amount
Bank Participation Loans	
Minnesota Twist Drill	$1,250,000
Greda/ASV	750,000
Fireside Investments	250,000
DMR Electronics	165,000
Industrial Rubber	160,000
North Lights	150,000
Hibbing Fabricators	150,000
Hedstrum Lumber	133,333
Watson Harmon	75,000
Total Participation Loans Issued	$3,083,333
IRRRB Direct Loans	
Institute of Advanced Technology	$100,000
Institute of Advanced Technology	100,000
Virginia/Eveleth Economic Development	94,395
Tower Economic Development	27,280
Tower Economic Development	25,615
Total Direct Loans Issued	$ 347,290
Total Loans Issued in Fiscal Year 1998	$3,430,623

Source: Minnesota Accounting and Procurement System.

The IRRRB Economic Development Department was responsible for maintaining controls over the loan application, approval, and disbursement process. Since each loan had unique circumstances, the statutes provided only broad guidance for IRRRB's loan program. Similarly, IRRRB's written guidelines for bank participation loans were flexible to accommodate the needs of each project. For direct loans, IRRRB used a formal application, screening, review, and authorization process.

In addition to the Economic Development Department's approval, loans funded by the Northeast Minnesota Economic Protection Fund also required the approval of IRRRB's Technical Advisory Committee, the IRRRB Board, and the Governor. Loans funded by the IRRR Board Account required the approval of the IRRRB board.

Defaulted and Uncollectible Loans

IRRRB regularly monitored its loan portfolio to ensure that repayments were current and to identify delinquent amounts. IRRRB identified a loan as delinquent if a payment was 30 days past due. IRRRB contacted delinquent borrowers (or the bank participating in the loan) to resolve the delinquency. If IRRRB had exhausted attempts to collect from a borrower, it reclassified the loan as uncollectible and began foreclosure proceedings, or had the participating bank prepare a closure statement and liquidate the assets. After foreclosure, IRRRB wrote off any remaining outstanding balance. IRRRB estimated that their actual loss on these loans would not exceed $500,000.

Of the $31 million of loans outstanding at June 30, 1998, IRRRB classified six loans with outstanding balances totaling $1,480,708 as delinquent. IRRRB also classified four loans with outstanding balances totaling $1,103,365 as being in foreclosure. During fiscal year 1998, IRRRB wrote off $125,615 as uncollectible.

A recently publicized loan was one that IRRRB made to Technimar Industries, a company that made a granite-like product for use in buildings and floors. IRRRB's involvement with Technimar included a $500,000 loan, a $600,000 incentive grant, and a $2,000,000 loan guarantee to the city of Cohasset, the site of Technimar's plant. As of June 30, 1998, IRRRB's $500,000 loan to Technimar was delinquent, due to Technimar's financial difficulties.

Reserve for Uncollectible Loans

IRRRB calculated a reserve for uncollectible loans based on a percentage of the loan receivable balance. The reserve for fiscal year 1998 was $114,713 for the IRRR Board account, and $1,855,534 for the Northeast Minnesota Economic Protection Fund. When IRRRB writes off uncollectible loans, it reduces the balance in the reserve account.

Audit Objectives and Methodology

Our review focused on the following questions:

- Did IRRRB design internal controls to provide reasonable assurance that loan issuances and repayments were properly authorized, calculated, and accurately reported in the accounting records?

- Did IRRRB comply with material finance-related legal provisions related to loan issuances and repayments?

To meet these objectives, we interviewed department employees to gain an understanding of the control structure in place over the loan issuances and the loan repayments. We performed detailed testing of specific transactions to determine that internal controls were in place and that loans complied with material finance-related legal provisions.

Conclusions

IRRRB properly recorded its financial activity in the states accounting system and complied with material finance-related legal provisions for the items tested. However, as discussed in Finding 1, IRRRB did not resolve reconciling items between their loan program records and the state's accounting system.

1. The IRRRB did not resolve differences between their record of outstanding loan balances and the balances recorded on the state's accounting system.

IRRRB maintained a loan program database to monitor loan issuances and repayments. The state's accounting system (MAPS) also recorded loan activity. The Department of Finance entered journal voucher transactions after the end of each month to record changes in the loan balances. To ensure the integrity of the loan balances, IRRRB compared their outstanding loan balances to the balances recorded on MAPS. Although IRRRB had worked with the Department of Finance, it had not been able to determine the reason for differences that have existed between the two systems for several years. The unexplained loan balance difference in the IRRR Board fund was nearly $5,000, while the difference in the Northeast Minnesota Economic Protection Fund approached $50,000.

Recommendation

- *The IRRRB should resolve the differences between their loan program database and the state's accounting system to ensure accurate financial reporting.*

Chapter 4. Giants Ridge Resort

Chapter Conclusions

IRRRB designed internal controls to provide reasonable assurance that Giants Ridge receipts were adequately safeguarded, accurately recorded, and properly reported in the state's accounting system.

IRRRB accurately processed and properly recorded Giants Ridge payroll and other administrative and operating disbursements on the state's accounting system.

In addition, for the items tested, IRRRB complied with material finance-related legal provisions, except that the restaurant vendor offered discounts to Giants Ridge employees, as explained in Finding 2.

A unique aspect of the IRRRB's operations is its ownership of the Giants Ridge Resort, which IRRRB created to enhance the hospitality industry on the iron range. Giants Ridge is a year-round recreational facility that offers downhill and cross-country skiing during the winter months and golf during the summer. Although it is IRRRB's intention that the resort generate revenue sufficient to cover its operating costs, IRRRB does not measure the value of the resort solely by its profitability. IRRRB also considers the resort's impact on the economic health of the surrounding communities and visitors' increased awareness of the beauty and potential of the iron range.

IRRRB accounted for Giants Ridge on the state's accounting system as a special revenue fund. The Legislature dedicated the resort's receipts to funding its operations. IRRRB covered any revenue shortfall with taconite production taxes appropriated to the board's operating account. The Giants Ridge director provided oversight for the resort operation. For the most part, state employees managed and operated the resort. Giants Ridge contracted with private vendors to provide some of the ski and golf course services.

Giants Ridge collected receipts from a variety of sources. Giants Ridge employees handled the collection of receipts for the ski operation and oversaw the collection of receipts handled by the private vendors. Giants Ridge employees also processed the administrative and operating expenditures of the resort. The largest expenditure was the operating reimbursement to the golf course management company. Other major expenditures were payroll, advertising, utilities, supplies, and equipment. Table 4-1 compares Giants Ridge's revenues and expenditures for fiscal years 1996, 1997, and 1998. As noted, the opening of the golf course in June 1997 resulted in significant increases in revenue and expenditures for fiscal year 1998.

Table 4-1
Giants Ridge Resort
Revenues and Expenditures
Fiscal Years 1996, 1997, and 1998

	Fiscal Year 1996	Fiscal Year 1997	Fiscal Year 1998
Revenues			
Admissions	$ 880,922	$ 896,410	$1,508,581
Retail Sales		612,383	829,935
Equipment/Facility Rental	85,182	100,192	128,166
Other Revenue	183,803	177,244	380,708
Total Revenue	$1,149,907	$1,786,228	$2,847,388 (1)
Expenditures			
Payroll	$ 780,872	$ 863,565	$ 938,506
Reimbursements, Management Fees, and Professional Services	214,181	579,623	1,310,885
Advertising/Promotions	98,330	80,455	95,760
Utilities	131,675	146,494	173,621
Other Administrative Expenditures	478,404	504,674	581,953
Total Expenditures	$1,703,462	$2,174,811	$3,100,725 (1)
Subsidy	($ 553,555)	($ 388,583)	($ 253,337)

(1) Significant increases in receipts and disbursements related to the golf course that opened in June 1997.

Note: This table is not intended to measure the results of operations, but rather to show the direct costs associated with the Giants Ridge Resort. IRRRB uses this information for management and budgetary purposes.

Source: Information provided by IRRRB as of 6/30/96, 6/30/97, and 6/30/98.

Giants Ridge accounting staff followed the state's purchasing guidelines. The department head and director approved purchases as necessary. Purchases over $5,000 required the approval of the IRRRB commissioner or deputy commissioner. Giants Ridge uses the state's personnel and payroll systems to compensate employees. Giants Ridge employees prepared timesheets, obtained supervisor's approvals, and forwarded them to the IRRRB main office, where they were reviewed and entered into the payroll system.

Table 4-2 shows the distribution of Giants Ridge's fiscal year 1998 financial activity between the ski operation, the golf course, and the restaurant.

Table 4-2
Giants Ridge Resort
Revenues and Expenditures by Operation
Fiscal Year 1998

	General Mgmt. & Marketing	Golf Course	Ski	Restaurant	Total
Revenues					
Admissions	$ 0	$684,137	$ 824,444	$ 0	$1,508,581
Retail Sales	0	179,889	0	650,046	829,935
Equipment/Facility Rental	0	55,435	72,731	0	128,166
Other Revenue	0	282,268	98,438	0	380,706
Total Revenue	$ 0	$1,201,729	$ 995,613	$650,046	$2,847,388
Expenditures					
Payroll	$115,589	$ 0	$ 822,917	$ 0	$ 938,506
Reimbursements, Management Fees, and Professional Services	0	777,548	0	533,337	1,310,885
Advertising/Promotions	95,760	0	0	0	95,760
Utilities	0	9,228	142,993	21,400	173,621
Other Operating Expenditures	116,848	103,098	337,153	24,854	581,953
Total Expenditures	$328,197	$ 889,874	$1,303,063	$579,591	$3,100,725

Note: This table is not intended to measure the results of operations, but rather to show the direct costs associated with the Giants Ridge Resort. IRRRB uses this information for management and budgetary purposes.

Source: Information provided by IRRRB.

In the following sections, we describe the history and development of the resort, the various relationships involved in the management of the facility, and the fiscal implications of those relationships.

Giants Ridge Ski Operations

IRRRB purchased the Giants Ridge site in 1983 and developed the ski operation. As of the 1997/1998 season, the site included a chalet, restaurant, gift shop, and the ski hills and lifts. The ski season generally runs from November through March. During fiscal year 1998, IRRRB reports that over 96,000 visitors used the ski resort facilities, generating ski revenues of $995,613.

For the most part, state employees managed and operated the ski resort. Giants Ridge employees performed most operational and administrative functions for the ski operation, including maintenance of the ski hills and lift equipment, collecting ski lift and equipment rental receipts, purchasing and paying for supplies and equipment, and processing personnel and payroll transactions. Some employees worked for the ski operation year round. IRRRB hired others on a seasonal, temporary basis, and, since the golf course began operations, IRRRB reassigned some employees from the golf operation.

IRRRB contracted with Northern Lights Sports (NLS) to provide ski rental equipment and ski lessons. Visitors paid for equipment rental and lessons when they bought their lift ticket, but presented a receipt to NLS staff to obtain the rented equipment and lessons. According to contract terms, NLS paid Giants Ridge twenty percent of the ski rental and lesson receipts. Since Giants Ridge actually collected the receipts, they paid NLS the 80 percent the company was due under the contract. For fiscal year 1998, Giants Ridge's share of the ski rental fees and ski lessons exceeded $27,000.

NLS also operated the ski gift shop. NLS collected and deposited gift shop revenues into their own account. Giants Ridge verified the gift shop receipts on a daily basis. At the end of the season, NLS paid IRRRB seventeen and one-half percent of the total gift shop receipts, according to contract terms. For fiscal year 1998, IRRRB reports they received over $18,000 as their share of the gift shop's revenue.

Giants Ridge Golf Operations

In 1993, IRRR Board approved the construction of the golf course, which opened in June 1997. The budget for the actual construction of the golf course was $4 million, but other costs, such as furnishings and site renovations, brought the total cost of the course to over $7 million. The golf course is typically open from May through October. IRRRB estimates that over 21,000 golfers used the course during the 1997 season.

In June 1996, IRRRB sold revenue bonds to finance the construction of the golf course. The bonds are not general obligations of the State of Minnesota, IRRRB, or any other agency or political subdivision of the state. The bond proceeds of $4,250,000 reimbursed IRRRB $2,844,685 for construction costs already incurred, provided $821,190 for the project's completion, paid $159,125 for the costs of the bond issue, and set aside $425,000 to meet the bond reserve requirements. IRRRB committed Giants Ridge's gross revenue and certain investment earnings to repay the bond principal and interest over a fifteen-year period. IRRRB may call the bonds after five years. IRRRB made the required principal and interest payments during fiscal years 1997 and 1998. The outstanding principal balance at June 30, 1998, was $4,085,000.

Unlike the ski operation, IRRRB hired a management company to oversee the golf operation and the related food and beverage concessions. A Texas based management company, Evergreen Alliance Golf Limited (EAGL), managed the golf course, pro shop, restaurant, and bar. The current contract with EAGL is effective through May 2000. Under the contract, EAGL managed and operated the golf course facilities and the food and beverage service facilities. EAGL hired and supervised all golf course employees. It collected and deposited all receipts, promoted and advertised the facilities, maintained the books and records of all financial transactions, maintained insurance coverage, and generally implemented all actions necessary for successful management and operation. In return, IRRRB reimbursed EAGL for it's operating costs and paid EAGL a fixed monthly management fee and annual contingent and incentive fees, as explained below:

- **Fixed Management Fees** – To compensate it for its management of the golf operations, IRRRB paid EAGL $5,000 each month through August 1996, and $3,200 each month after that. The contract allowed for annual adjustments to the monthly payment amounts based on the Consumer Price Index.

To compensate EAGL for their management of the food and beverage services, IRRRB paid it $1,000 each month through April 1997; at which point the contract discontinued the fixed management fees for food and beverage services.

- **Contingent Management Fees** – IRRRB further compensated EAGL for its management of the golf operations based on the golf course's gross receipts. IRRRB agreed to pay EAGL 8.6 percent of receipts exceeding $650,000, and 7.5 percent of receipts exceeding $1 million. The contract capped this contingent fee at the amount paid to EAGL as fixed fees for the year. The contract also stated that EAGL would receive 40 percent of the adjusted gross profit derived from sales of merchandise. For the period ending December 31, 1997, Giants Ridge paid EAGL $12,061 for the 8.6 percent contingent fee and $21,575 for the 40 percent merchandise contingent fee.

  The contract contained a similar contingent management fee provision for the operation of the food and beverage services requiring IRRRB to pay EAGL 50 percent of the food and beverage operation's profit through April 1997 that exceeded $40,000. After April 1997, the 50 percent applied to profit exceeding $50,000. For the period ending April 1998, Giants Ridge paid EAGL $5,625 for the contingent fee.

Audit Objectives and Methodology

The primary objectives of our audit of the Giants Ridge Resort were to answer the following questions:

- Did IRRRB design and implement internal controls to provide reasonable assurance that Giants Ridge revenue was safeguarded, deposited, accurately reported in the state's accounting system, and in compliance with applicable legal provisions?

- Did IRRRB design internal controls to provide reasonable assurance that Giants Ridge payroll and other administrative and operating disbursements were properly authorized, adequately supported, properly recorded on the state's accounting system, and in accordance with applicable finance-related legal provisions?

To answer these questions, we interviewed department personnel to gain an understanding of the receipt processes, and reviewed controls over receipt processing, collection, and deposit. In addition, we tested samples of transactions to determine if receipts were accurately deposited and recorded on the state's accounting system. We also interviewed department personnel to gain an understanding of the processes for payroll and other disbursements. Our methodology included analytical reviews, tests of transaction details and balances, and tests of compliance.

Conclusions

IRRRB designed internal controls to provide reasonable assurance that Giants Ridge receipts were adequately safeguarded, accurately recorded, and properly reported in the state's accounting system. IRRRB accurately processed and properly recorded Giants Ridge payroll and other administrative and operating disbursements on the state's accounting system. In addition, for the items tested, IRRRB complied with material finance-related legal provisions, except as noted in Finding 2.

2. EAGL offered Giants Ridge employees a ten percent discount for meals at the restaurant.

EAGL, the management company hired by Giants Ridge to manage the golf course, also managed the restaurant. EAGL offered Giants Ridge employees a ten percent discount at the restaurant. Any employees accepting this offer violated the code of ethics for executive branch employees, as explained in Minn. Stat. Chapter 43A.38. This statute prohibits state employees from accepting any direct or indirect payment of expense as a result of their employment. Since EAGL limited their offer to Giants Ridge employees, the offer was available to employees as a result of their employment.

Also, since EAGL deposited all receipts with IRRRB and the discount reduced receipts, IRRRB unknowingly subsidized the discount.

Recommendations

- *IRRRB should inform its employees about statutory limitations regarding acceptance of gifts or other benefits.*
- *IRRRB should instruct EAGL to discontinue restaurant discounts to Giants Ridge employees.*

Chapter 5. Ironworld Operations

Chapter Conclusions

IRRRB designed internal controls to provide reasonable assurance that it safeguarded, deposited, and accurately reported Ironworld receipts, in compliance with finance related legal provisions. However, as discussed in Finding 3, IRRRB needs to improve its monitoring of the Ironworld gift shop's gross receipts.

IRRRB designed internal controls to provide reasonable assurance it accurately processed and properly recorded Ironworld payroll and other expenditures on the state's accounting system. In addition, for the items tested, IRRRB complied with material finance related legal provisions.

IRRRB developed Ironworld USA to attract tourists to the area and to showcase the region's heritage and resources. Located in Chisholm, it opened to the public in 1980. It began as the Iron Range Research and Interpretative Center, but IRRRB later added other recreational enhancements, including a railway system, an amphitheater, a festival park, an ethic restaurant, and a miniature golf course. Hibbing Taconite conducted mine tours at Ironworld. Table 5-1 shows IRRRB's recap of Ironworld's revenues and expenses for fiscal years 1996, 1997, and 1998. IRRRB's subsidy of the facility is a part of its economic development mission.

Table 5-1
Ironworld USA
Statement of Revenues and Expenditures
Fiscal Years 1996, 1997, and 1998

	FY1996	FY1997	FY1998
Revenues			
Admissions	$ 214,778	$ 205,572	$ 171,888
Concessions	30,093	51,123	104,444
Other Revenue	205,121	174,165	120,573
Total Revenue	$ 449,992	$ 430,860	$ 396,905
Expenditures			
Payroll	$1,166,525	$1,045,547	$1,022,330
Advertising/Promotions	152,564	95,190	218,077
Utilities/Maintenance	157,480	177,170	159,547
Purchased Services/Reimbursements	258,235	502,443	348,842
Administrative Expenditures	367,313	380,346	322,127
Total Expenditures	$2,102,117	$2,200,696	$2,070,923
Subsidy	($1,652,125)	($1,769,836)	($1,674,018)

Note: This table is not intended to measure the results of operations, but rather to show the direct costs associated with the Giants Ridge Resort. IRRRB uses this information for management and budgetary purposes.

Source: Information provided by IRRRB as of 6/30/96, 6/30/97, and 6/30/98.

Iron Range Resources and Rehabilitation Board

IRRRB collected most of Ironworld's receipts from visitors as they entered the facility. At the main entrance, visitors paid for their general admission to the facility and bought tickets for the mine tour, a major attraction. IRRRB collected receipts for other attractions, such as mini golf and remote control boats, inside the facility. IRRRB employees deposited all these receipts into the state's account. They also performed various reconciliations of the receipts to the cash register tapes, admission counters, and other evidence to ensure that they deposited all receipts into the bank and that they accurately recorded those receipts on the state's accounting system.

Ironworld's largest disbursement category was payroll. IRRRB employees at Ironworld forwarded approved timesheets to the IRRRB main office, where timesheets were reviewed and entered into the state's payroll system. Other major expenditures were advertising, utilities, supplies, and entertainers. IRRRB employees at Ironworld processed these disbursements through the state's accounting system. IRRRB's Ironworld accounting staff followed the state's purchasing guidelines. The department head and director of IRRRB approved purchases as necessary. Purchases over $5,000 required the approval of the IRRRB commissioner or deputy commissioner.

IRRRB contracted with non-state vendors for the operation and management of the Ironworld gift shop and its food and beverage services.

- The food and beverage vendor provided food and beverage services throughout Ironworld, including the restaurant and catering services. The contract for the 1998 season, with A & R Catering & Food Service Management, Inc., required that the vendor deposit the receipts for the day in the state's account at a bank in Chisholm. The vendor provided IRRRB with a copy of the register tape and the bank deposit receipt. To compensate the vendor for its services, IRRRB paid the vendor a percentage of the receipts. The contract also specified, as an incentive fee, that IRRRB pay the vendor 50 percent of the net profit for the season.

  During the 1997 operating season, IRRRB discovered that the former food and beverage vendor was misappropriating state money. They contacted local law enforcement to pursue criminal prosecution of the vendor. They also referred the theft to the Attorney General's office for any civil proceedings against the vendor. IRRRB obtained a $70,000 civil judgement against the vendor. Ironworld more closely monitored the new vendor's operations.

- The gift shop vendor paid IRRRB $5,000 a month to rent the gift shop space. The gift shop operator retained the gift shop receipts, deposited the money in a private bank account, and reported receipt information to Ironworld. The contract with the gift shop operator also provided that IRRRB receive ten percent of the gift shop's receipts that exceeded $75,000. IRRRB employees monitored the reasonableness of the gift shop's receipts by comparing the reported receipts to expected receipts based on attendance levels. Finding 3 notes a weakness in Ironworld's monitoring of gift shop receipts.

Audit Objectives and Methodology

The primary objectives of our audit were to answer the following questions:

Iron Range Resources and Rehabilitation Board

- Did IRRRB design and implement internal controls to provide reasonable assurance that Ironworld revenue was safeguarded, deposited, accurately reported in the state's accounting system, and in compliance with applicable legal provisions?

- Did IRRRB design internal controls to provide reasonable assurance that Ironworld payroll and other administrative expenditures were properly authorized, adequately supported, properly recorded on the state's accounting system, and in compliance with applicable legal provisions?

To answer these questions, we interviewed department personnel to gain an understanding of the receipt, purchasing, disbursement, and payroll processes. The methodology used to evaluate these objectives included analytical reviews, sample tests of transactions, and tests of compliance.

Conclusions

IRRRB designed internal controls to provide reasonable assurance that it safeguarded, deposited, and accurately reported Ironworld's receipts in compliance with finance-related legal provisions. However, as discussed in Finding 3, IRRRB needs to improve its monitoring of the Ironworld gift shop's gross receipts.

IRRRB designed internal controls to provide reasonable assurance that it accurately processed and properly recorded Ironworld's payroll and other expenditures on the state's accounting system. In addition, for the items tested, IRRRB complied with material finance-related legal provisions.

3. IRRRB did not verify the gross receipts of the Ironworld gift shop for the contract ended December 31, 1997.

Although IRRRB employees did monitor the Ironworld gift shop's receipts on a daily basis, they did not determine whether the total for the season exceeded $75,000. According to the contract terms, if the Ironworld gift shop's total gross receipts exceeded that amount, the vendor had to pay IRRRB ten percent of the excess amount. Based on attendance levels, IRRRB was confident that the vendor's collections had not exceeded the gross revenue threshold and that the vendor did not owe funds to the state.

Recommendation

- *IRRRB should monitor the Ironworld gift shop's receipts to ensure that the vendor makes all payments required by the contract.*

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Status of Prior Audit Issues

Most Recent Audits

<u>Legislative Audit Report 94-38</u>, issued in August 1994, covered the audit period from July 1, 1990, through June 30, 1993. The audit examined IRRRB's administration of Taconite Production Tax receipts, reimbursements to mining companies, investment income, grant disbursements, loan issuance and repayments, and payroll. The report included nine findings.

The first finding identified that IRRRB had not spent or cancelled part of a 1987 appropriation. IRRRB has since cancelled the $890,000 appropriation.

We were also concerned about IRRRB's control over the administration of grants. IRRRB rewrote its guidelines for the grant guidelines to allow for greater administrative flexibility and board oversight. Next, we questioned whether the taconite relief area had benefited from an IRRRB funded conference held in Duluth. We recommended that IRRRB ensure that its projects provide benefit to the taconite relief area. IRRRB maintained that the questioned project did provide such benefit and that it does consider the benefit to the taconite relief area in its assessment of all projects.

We also found weaknesses in IRRRB's administration of loans. We felt that IRRRB needed to develop formal loan issuance guidelines for direct loans. IRRRB maintained that the flexibility needed to administer the direct loans precluded the establishment of general guidelines. IRRRB believed that due diligence within the department and the oversight of the board provided sufficient safeguards to ensure the appropriateness of the loans. We also recommended that IRRRB improve its oversight of delinquent bank participation loans. IRRRB has made changes in their monitoring of bank participation loans to provide better oversight.

Finally, we questioned some expenses reimbursed to contractors. IRRRB no longer has contracts with these vendors.

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 the University of Minnesota and 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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IRON RANGE RESOURCES & REHABILITATION BOARD

P.O. Box 441, Highway 53 South
Eveleth, Minnesota 55734-0441
(218) 744-7400 • 800-765-5043
Fax: (218) 744-7401

October 21, 1998

Mr. James Nobles
Legislative Auditor
Office of the Legislative Auditor
Centennial Building
658 Cedar Street
St. Paul, MN 55155

Dear Mr. Nobles:

The following is the IRRRB's response to the FY 96-98 audit findings as presented and discussed by the Office of the Legislative Auditor on October 19, 1998.

Finding 1. The IRRRB did not resolve differences between their record of outstanding loan balances and the balances recorded on the State's accounting system.

The Agency notified the Department of Finance of this issue when first discovered by the Agency. The Agency has attempted to determine the approximate time frame and dollar amounts involved in the reconciliation in order to assist Finance in resolving this issue. The Agency does not have the ability to access state system records which may assist in the reconciliation and is relying on Finance to provide assistance in this matter. The Agency will provide whatever assistance necessary to Finance in order to resolve the differences. Finance has indicated the differences may have occurred in the conversion to the MAPS system. In addition, the Agency performs regular reconciliations on a quarterly and annual basis in order to insure that no new differences exist. Also, the Agency is relying upon its internal loan records to be correct as controls are in place to detect discrepancies on an individual loan balance.

Resolution and Responsible Party: The Agency's Chief Financial Officer will continue to work with Finance to attempt to resolve this finding.

Finding 2. EAGL offered Giants Ridge employees a ten percent discount for meals at the restaurant.

The Agency acknowledges the statutory language prohibiting this practice. The Agency's restaurant manager (EAGL) did not deliberately attempt to violate this statute. EAGL has implemented this practice in restaurant operations they manage as an employee incentive and to generate additional revenue. The practice is customary and standard in the restaurant business. In addition, Giants Ridge is located six miles from the nearest restaurant and offers the employees an alternative to traveling to eat their meals.

Resolution and Responsible Party: The Facility Manager at Giants Ridge along with the management of EAGL will immediately discontinue the practice of offering this discount. A new method of providing a discount to all patrons of the restaurant will be evaluated and discussed.

Finding 3. IRRRB did not verify gross receipts of the Ironworld gift shop for the contract ended December 31, 1997.

As a result of monitoring facility daily attendance and sales activity, Ironworld management felt the gift shop sales did not exceed the specified dollar amount in the contract and therefore did not request formal verification from the vendor. Also in discussing the FY98 contract, the vendor informally confirmed this finding as they requested a reduction in rent to better match sales against their cost of operations.

Resolution and Responsible Party: The facility manager will immediately request verification of the FY97 sales activity for the vendor.

This concludes our response to the audit findings. We wish to thank the Office of the Legislative Auditor for their assistance and cooperation.

Sincerely,

Jim Gustafson

Jim Gustafson
Commissioner