

XI. Compliance Audit

“a copy of the most recent compliance audit.”

The most recent compliance audit was released by the Office of the Legislative Auditor on February 11, 2016. The LCCMR has addressed all of the findings and recommendations identified in the audit. A letter dated November 10, 2016 from the University of Minnesota summarizes the joint actions of the LCCMR and University of Minnesota.

UNIVERSITY OF MINNESOTA

Twin Cities Campus

*Office of the Vice President and Chief
Financial Officer / Treasurer*

Office of the President

334B Morrill Hall
100 Church Street SE
Minneapolis, MN 55455

Office: 612-625-4517
Fax: 612-626-2278
<http://www.budget.umn.edu/>
Email: ubudget@umn.edu

November 10, 2016

Susan Thornton, Director
Legislative-Citizen Commission on Minnesota Resources
100 Rev Dr. Martin Luther King Jr. Blvd.
State Office Building, Room 65
St. Paul, MN 55155

Dear Ms. Thornton:

The Office of the Legislative Auditor's Report on the Environment and Natural Resources Trust Fund (ENTRF) issued February 11, 2016 found, "The statute governing how the state pays money appropriated from the Environment and Natural Resources Trust Fund to the University of Minnesota is in conflict with the statute governing the investment of trust fund money." The audit report went on to state:

We think the state has a duty to reduce the time between when the money leaves the trust fund and when the university spends it, so that earnings to the trust fund can be maximized and added to the trust fund's balance for future appropriation by the Legislature. Alternatively, the university could return to the state income earned through investment of unspent money from the trust fund.

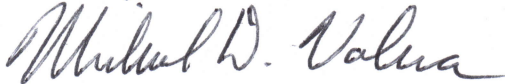
The University responded to the Legislative Auditor's report by supporting a statutory change to modify the State's payment schedule for ENTRF appropriations. The University preferred this option rather than submitting long-term payments to the state related to future appropriations. To implement the statutory change, the University worked with the Legislative-Citizen Commission on Minnesota's Resources (LCCMR), the Legislature, and MN Management and Budget to amend Minnesota Statutes 137.025, the University's appropriation statute. This statutory change became law in 2016 Session, Chapter 186. Beginning in FY 2017, all University ENTRF appropriations will be made on a reimbursement basis; therefore, the Legislative Auditor's recommendation was implemented.

Because the University continues to earn interest on unspent funds from past appropriations, the University also agreed to submit quarterly payments to the State for interest earned from the date the University became aware of the issue until unspent funds drawn under the old method are expended. The University made its first interest payment in August 2016 for \$217,343, and the second interest payment will be made in late November for \$24,624. The University will continue to make interest payments until all funds drawn under the old method are expended. Additional details on these payments were submitted to you in a letter on April 19, 2016.

In a July 22, 2016 letter to President Kaler, the LCCMR also requested the University of Minnesota submit a payment to the State for \$511,714 for interest the University earned prior to the release of the Legislative Auditor's report. This payment was made to the State of Minnesota on November 2, 2016.

Based on your July 22nd correspondence and the University's actions to date, we understand this issue to be resolved. Please contact me with any questions on the University of Minnesota's actions to date.

Sincerely,

A handwritten signature in cursive script, reading "Michael D. Volna".

Michael Volna

Interim Vice President and Chief Financial Officer



FINANCIAL AUDIT DIVISION REPORT

**Environment and Natural
Resources Trust Fund**

**Internal Controls and
Compliance Audit**

July 2012 through February 2015

February 11, 2016

Report 16-03

FINANCIAL AUDIT DIVISION

Centennial Building – Suite 140

658 Cedar Street – Saint Paul, MN 55155

Telephone: 651-296-4708 • Fax: 651-296-4712

E-mail: auditor@state.mn.us • Website: <http://www.auditor.leg.state.mn.us>

Through Minnesota Relay: 1-800-627-3529 or 7-1-1

Financial Audit Division

The 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 has a staff of about 30 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.

The Office of the Legislative Auditor (OLA) also has a Program Evaluation Division, which evaluates topics periodically selected by the Legislative Audit Commission.

Reports issued by both OLA divisions are solely the responsibility of OLA and may not reflect the views of the Legislative Audit Commission, its individual members, or other members of the Minnesota Legislature. For more information about OLA reports, go to:

<http://www.auditor.leg.state.mn.us>

To obtain reports in electronic ASCII text, Braille, large print, or audio, call 651-296-4708. People with hearing or speech disabilities may call through Minnesota Relay by dialing 7-1-1 or 1-800-627-3529.

To offer comments about our work or suggest an audit, investigation, or evaluation, call 651-296-4708 or e-mail legislative.auditor@state.mn.us.

Conclusion on Internal Controls

The Financial Audit Division bases its conclusion about an organization's internal controls on the number and nature of the control weaknesses we found in the audit. The three possible conclusions are as follows:

Conclusion	Characteristics
Adequate	The organization designed and implemented internal controls that effectively managed the risks related to its financial operations.
Generally Adequate	With some exceptions, the organization designed and implemented internal controls that effectively managed the risks related to its financial operations.
Not Adequate	The organization had significant weaknesses in the design and/or implementation of its internal controls and, as a result, the organization was unable to effectively manage the risks related to its financial operations.



OFFICE OF THE LEGISLATIVE AUDITOR

STATE OF MINNESOTA • James Nobles, Legislative Auditor

February 11, 2016

Representative Sondra Erickson, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Representative John Persell, Co-Chair, Legislative-Citizen Commission on Minnesota Resources
Senator David Tomassoni, Co-Chair, Legislative-Citizen Commission on Minnesota Resources
Nancy Gibson, Co-Chair, Legislative-Citizen Commission on Minnesota Resources
Members of the Legislative-Citizen Commission on Minnesota Resources

Susan Thornton, Director
Legislative-Citizen Commission on Minnesota Resources

Richard B. Beeson, Chair, University of Minnesota Board of Regents
Members of the University of Minnesota Board of Regents
Eric Kaler, President, University of Minnesota

Adam Duininck, Chair, Metropolitan Council
Members of the Metropolitan Council

Thomas Landwehr, Commissioner
Department of Natural Resources

This report presents the results of our internal controls and compliance audit of the Environment and Natural Resources Trust Fund (trust fund) for the period from July 2012 through February 2015. The objectives of this audit were to determine if the Department of Natural Resources, University of Minnesota, and the Metropolitan Council had adequate internal controls to ensure they used trust fund appropriations for the intended purposes and complied with applicable legal requirements.

This audit was conducted by Brad White, CPA, CISA, CFE (Audit Director), Carmen Marg-Patton, CPA, CFE (Audit Supervisor), and auditors Sandy Ludwig and Nick Ludwig, CPA.

We received the full cooperation of the staff from each organization while performing this audit.

James R. Nobles
Legislative Auditor

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

Table of Contents

	<u>Page</u>
Report Summary	1
Background	3
Audit Objective, Scope, and Methodology	5
Audit Criteria	7
Conclusion	10
Findings and Recommendations	11
1. The Metropolitan Council did not have adequate internal controls and did not sufficiently monitor whether grant recipients used Environment and Natural Resources Trust Fund money in compliance with state laws.....	11
2. Land purchased by a Metropolitan Council grant recipient did not comply with legal requirements prohibiting the use of Environment and Natural Resources Trust Fund money for the purchase of residential structures	14
3. The Metropolitan Council did not ensure its grant recipients complied with a statute requiring entities to record a notice of funding restrictions when purchasing land with money from the Environment and Natural Resources Trust Fund	15
4. The Department of Natural Resources could not show how administrative costs allocated to the Environment and Natural Resources Trust Fund complied with the requirement that all costs must be “directly related to and necessary for” specific projects or activities listed in the appropriation law	15
5. The statute governing how the state pays money appropriated from the Environment and Natural Resources Trust Fund to the University of Minnesota is in conflict with the statute governing the investment of trust fund money.....	19
Agencies Responses	21
Legislative-Citizen Commission on Minnesota Resources	21
Metropolitan Council	23
Natural Resources	27
University of Minnesota	29

Report Summary

Background

The Office of the Legislative Auditor conducted an audit of the Environment and Natural Resources Trust Fund (trust fund) to determine whether entities spent money from the trust fund in accordance with state law. The audit assessed internal controls over the use of trust fund money at the Department of Natural Resources, Metropolitan Council, and University of Minnesota. The audit examined expenditures from the trust fund from July 2012 through February 2015. During that period, the State of Minnesota spent over \$77 million of trust fund money, and the three entities we audited received about \$70 million of the amount that was spent.

The voters of Minnesota established the Environment and Natural Resources Trust Fund through a constitutional amendment in 1988 for the purpose of protecting, conserving, preserving, and enhancing the state's air, water, land, fish, wildlife, and other natural resources. The trust fund receives its money from proceeds of the Minnesota State Lottery and investment income earned by the fund. Forty percent of the net proceeds of the state lottery are deposited in the trust fund and 5.5 percent of the market value of the trust fund can be appropriated by the Legislature each year. Since 1991, the Legislature has appropriated approximately \$500 million for about 1,000 projects around the state. As of March 2015, the market value of trust fund investments was \$894 million.

Conclusion

The Metropolitan Council did not have adequate internal controls over monitoring grant recipients' use of money from the Environment and Natural Resources Trust Fund appropriations. The projects and grants we tested at the Metropolitan Council generally complied with significant finance-related legal requirements and used money from the Environment and Natural Resources Trust Fund appropriations in compliance with the legal purposes contained in the state constitution, state statutes, and appropriation laws. However, we found some costs that did not comply with specific legal requirements.

The Department of Natural Resources generally had adequate internal controls to ensure it used money from the Environment and Natural Resources Trust Fund appropriations for the intended purposes; however, the department had some weaknesses in internal controls. In addition, projects and grants we tested at the Department of Natural Resources generally complied with significant finance-related legal requirements and used money from the Environment and Natural Resources Trust Fund appropriations in compliance with the legal purposes

contained in the state constitution, state statutes, and appropriation laws. However, we found some costs that did not comply with specific legal requirements.

The University of Minnesota had adequate internal controls to ensure that it used money from the Environment and Natural Resources Trust Fund appropriations for the intended purposes. In addition, the projects and grants we tested at the University of Minnesota complied with significant finance-related legal requirements and used money from the Environment and Natural Resources Trust Fund appropriations in compliance with the legal purposes contained in the state constitution, state statutes, and appropriation laws. However, the statutory requirement for how the state pays money from the trust fund to the university conflicts with the statutory requirement for investment of money in the trust fund.

Findings

- The Metropolitan Council did not have adequate internal controls and did not sufficiently monitor whether grant recipients used Environment and Natural Resources Trust Fund money in compliance with state laws. ([Finding 1, page 11](#))
 - Land purchased by a Metropolitan Council grant recipient did not comply with legal requirements prohibiting the use of Environment and Natural Resources Trust Fund money for the purchase of residential structures. ([Finding 2, page 14](#))
 - The Metropolitan Council did not ensure its grant recipients complied with a statute requiring entities to record a notice of funding restrictions when purchasing land with money from the Environment and Natural Resources Trust Fund. ([Finding 3, page 15](#))
 - The Department of Natural Resources could not show how administrative costs allocated to the Environment and Natural Resources Trust Fund complied with the requirement that all costs must be “directly related to and necessary for” specific projects or activities listed in the appropriation law. ([Finding 4, page 16](#))
 - The statute governing how the state pays money appropriated from the Environment and Natural Resources Trust Fund to the University of Minnesota is in conflict with the statute governing the investment of trust fund money. ([Finding 5, page 19](#))
-

Background

Environment and Natural Resources Trust Fund

In 1988, Minnesota voters approved a constitutional amendment to establish the Environment and Natural Resources Trust Fund (trust fund) for the purpose of protecting, conserving, preserving, and enhancing the state's air, water, land, fish, wildlife, and other natural resources.¹ The trust fund receives its money from proceeds of the Minnesota State Lottery and investment income earned by the fund. The constitutional amendment specified that until 2025, not less than 40 percent of the net proceeds of the state lottery must be deposited in the trust fund. The Minnesota State Board of Investment invests the trust fund's assets and reinvests the income generated from these investments back into the trust fund. As of March 2015, the State Board of Investment had recorded the market value of trust fund investments at \$894 million.

The constitutional amendment allows the Legislature to appropriate up to 5.5 percent of the market value of the trust fund each year. The Legislative-Citizen Commission on Minnesota Resources (the commission), a committee of 17 legislators and citizens, assists the Legislature by making funding recommendations and monitoring trust fund projects. The commission employs a director, Susan Thornton, and three other staff members. The commission issues annual or biennial requests for proposals that are open to any entity, including all state agencies, quasi-state agencies, and nonprofit organizations. Commission members review, evaluate, and rank submitted project proposals. The commission, as a whole, selects the projects to recommend for funding and submits the recommendations to the Legislature. Based on the commission's recommendations, the Legislature appropriates funding to entities for the proposed projects.

Table 1 summarizes the trust fund appropriations for fiscal years 2010-2015.²

¹ *Minnesota Constitution*, Article XI, Section 14.

² An appropriation is a legislative action that authorizes money for a specific purpose.

Table 1
Environment and Natural Resource Trust Fund Appropriations
Fiscal Years 2010 through 2015^{Note 1}
(In thousands)

Entity	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	Total
Department of Natural Resources	\$15,148	\$14,554	\$18,421	\$18,432	\$16,892	\$12,630	\$ 96,077
University of Minnesota	1,980	7,796	3,215	3,882	11,767	16,640	44,280
Board of Water and Soil Resources	3,425	2,235	1,781	1,106	3,771	957	13,275
Metropolitan Council	1,290	0	1,125	1,125	0	1,500	5,040
Legislative-Citizen Commission on Minnesota Resources	1,054	0	473	473	990	100	3,090
Department of Commerce	2,000	0	0	0	0	0	2,000
Department of Agriculture	0	0	250	250	590	621	1,711
Science Museum of Minnesota	300	0	0	0	0	900	1,200
Pollution Control Agency	425	0	0	0	0	743	1,168
Others ^{Note 2}	<u>0</u>	<u>894</u>	<u>63</u>	<u>60</u>	<u>0</u>	<u>689</u>	<u>1,706</u>
Total	<u>\$25,622</u>	<u>\$25,479</u>	<u>\$25,328</u>	<u>\$25,328</u>	<u>\$34,010</u>	<u>\$34,780</u>	<u>\$170,547</u>

Note 1. While we limited the scope of our audit to Trust Fund expenditures occurring from July 2012 through February 2015, appropriations authorizing those expenditures were available as early as fiscal year 2010.

Note 2. Others include the Department of Health, Minnesota Zoological Garden, University of Minnesota-Duluth, Department of Education, Minnesota State Colleges and Universities, and Legislative Coordinating Commission.

Source: *Laws of Minnesota* 2009, chapter 143; *Laws of Minnesota* 2010, chapter 362; *Laws of Minnesota* 2011, First Special Session, chapter 2, art. 3; *Laws of Minnesota* 2012, chapter 264, art. 4; *Laws of Minnesota* 2013, chapter 52; and *Laws of Minnesota* 2014, chapter 226 and chapter 312, art. 12, sec. 8.

After the Legislature appropriates money for a project, the commission requires the recipient of the appropriation to submit a work plan for the commission's approval before beginning work on the project. The commission continues to monitor the project by reviewing biannual status updates and final reports submitted by the recipient of the appropriation.

Audit Objective, Scope, and Methodology

The objective for our audit of Environment and Natural Resources Trust Fund expenditures made during the period from July 2012, through February 2015, was to answer the following questions:³

- Were the audited entity's internal controls adequate to ensure that it used money from the Environment and Natural Resources Trust Fund appropriations for the intended purposes?

³ Our audit did not assess the quality of the oversight provided by the Legislative-Citizen Commission on Minnesota Resources, examine Trust Fund expenditures made by the commission, determine whether appropriation goals were met, or evaluate the State Board of Investment's practices related to its investment of the trust fund's assets.

- For the items tested, did the audited entity spend money from the Environment and Natural Resources Trust Fund in compliance with the state constitution, state statutes, and appropriation laws?

To meet the audit objective, we gained an understanding of the various finance-related legal provisions, including the state's constitution, statutes, and appropriation laws. We considered the risk of noncompliance with these finance-related legal requirements and the risk of ineligible expenditures occurring without detection. We analyzed the state's accounting data to understand how money from the trust fund had been used, to identify transactions requiring further review because they seemed inappropriate based on the nature of the project, and to identify unusual trends or significant changes in financial operations. Based on the type, dollar amount, and analysis of the expenditures, we selected the following three entities for testing:

- Department of Natural Resources - The department used money from the trust fund for a variety of project types, including grants, land purchases, restorations, and research.⁴
- University of Minnesota - The university used trust fund money mostly for research projects.
- Metropolitan Council - The council used trust fund money solely for grants to other entities for land purchases.⁵

Table 2 identifies the total expenditures recorded on the state's accounting system by entity for fiscal years 2013, 2014, and 2015. Please note that amounts shown for the University of Minnesota and the Metropolitan Council represent the state's payments to those entities, not the entities' subsequent use of the money. The entities we audited are in bold.

⁴ We coordinated the audit work of the Environment and Natural Resources Trust Fund at the Department of Natural Resources and Metropolitan Council with a separate, but similar, audit of the Legacy Amendment - Parks and Trails Fund.

⁵ Ibid.

Table 2
Environment and Natural Resources Trust Fund
Expenditures by Entity
July 2012 through June 2015 ^(Note 1)
By Fiscal Years

<u>Entity</u>	<u>FY 2013</u>	<u>FY 2014</u>	<u>FY 2015¹</u>	<u>Total</u>
Department of Natural Resources	\$16,562,633	\$13,603,188	\$14,705,249	\$44,871,070
University of Minnesota ^(Note 2)	3,882,000	11,767,000	16,940,000	32,589,000
Board of Water and Soil Resources	1,450,632	1,814,704	1,991,758	5,257,094
Metropolitan Council ^(Note 2)	0	2,878,299	0	2,878,299
Legislative Entities ^(Note 3)	393,131	472,731	461,981	1,327,843
Department of Agriculture	185,152	248,169	314,316	747,637
Other Entities ^(Note 4)	307,009	129,440	339,246	775,695
Total Expenditures	<u>\$22,780,557</u>	<u>\$30,913,531</u>	<u>\$34,752,550</u>	<u>\$88,446,638</u>

Note 1. For fiscal year 2015, our audit scope included expenditures (through February 2015) totaling \$23,283,571. The table above shows fiscal year 2015 expenditures through the end of the fiscal year, June 30, 2015.

Note 2. Amounts shown for the University of Minnesota and the Metropolitan Council represent the state's payments to those entities, not the entities' subsequent use of the money. The state paid money to the university in 12 monthly installments, as required by statute. The state provided money to the Metropolitan Council on a reimbursement basis.

Note 3. Legislative entities that used money from the trust fund include the Legislative-Citizen Commission on Minnesota Resources and the Legislative Coordinating Commission.

Note 4. Other entities include departments of Health and Education, Pollution Control Agency, Minnesota State Colleges and Universities, Minnesota Zoological Garden, and Science Museum of Minnesota.

Source: State of Minnesota's accounting system.

To accomplish our objective, we interviewed staff at the entities to gain an understanding of their internal controls over expenditures from the trust fund. We selected a sample of appropriations, grants, and financial transactions and reviewed supporting documentation to determine whether the entities' controls were effective and if the transactions complied with the state constitution, state statutes, appropriation laws, and grant and contract provisions.

For trust fund money spent by the University of Minnesota, we coordinated our work with the university's Office of Internal Audit. We selected the appropriations for the audit and oversaw the design and completion of the audit procedures. We reviewed the Office of Internal Audit's findings and supporting audit documentation.⁶

We conducted the audit in accordance with generally accepted government auditing standards applicable to performance audits. 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.

⁶ Office of Internal Audit, University of Minnesota, *Environment and Natural Resources Trust Fund*, Report 1602, September 2015 (Minneapolis, MN).

Audit Criteria

We used various criteria to evaluate internal controls and compliance. We used, as our criteria to evaluate internal controls, the most recent edition of the internal control standards published by the U.S. Government Accountability Office.⁷ We used various legal resources to assess compliance and whether project costs were allowable, including the following:

- *Minnesota Constitution*, art. XI, sec.14
- *Minnesota Statutes* 2014, chapter 116P
- Laws appropriating money from the Trust Fund
 - *Laws of Minnesota* 2009, chapter 143
 - *Laws of Minnesota* 2010, chapter 362
 - *Laws of Minnesota* 2011, First Special Session, chapter 2, art. 3
 - *Laws of Minnesota* 2012, chapter 264, art. 4
 - *Laws of Minnesota* 2013, chapter 52
 - *Laws of Minnesota* 2014, chapter 226
 - *Laws of Minnesota* 2014, chapter 312, art. 12, sec. 8

Legal Compliance Challenges. Entities using money from the trust fund face challenges to ensure compliance with two specific legal requirements. These two requirements, discussed further below, parallel requirements established for money used from the state's four Legacy funds.⁸ We discussed these compliance challenges in a 2011 program evaluation report about the Legacy funds⁹ and, because of the similarities, we considered our analysis in that report to help us apply the requirements for the trust fund. Understanding these requirements has been challenging primarily because they are subject to conflicting interpretations.

⁷ Comptroller General of the United States, Government Accountability Office, *Standards for Internal Control in the Federal Government*, (Washington D.C., September 2014). The Department of Management and Budget has adopted these federal standards as the internal control framework for the executive branch. In addition, the Metropolitan Council is in the process of adopting these federal standards as its internal control framework.

⁸ The state's four Legacy funds (Outdoor Heritage Fund, Clean Water Fund, Parks and Trails Fund, and Arts and Cultural Heritage Fund) were established by a constitutional amendment in 2008 and are funded through an increase in the state's sales tax.

⁹ Office of the Legislative Auditor, Program Evaluation Division, *The Legacy Amendment*, November 2011, pages 45-58 (St. Paul, MN).

- **Costs must be directly related to and necessary for the purposes of the appropriation.** The Legislature and the Legislative-Citizen Commission on Minnesota Resources have worked to limit the use of trust fund money for administrative costs.¹⁰ The objective has been to use as much trust fund money as possible for costs directly associated with the purposes of an appropriation and to limit the use of trust fund money for administrative costs. However, the line that separates direct costs and administrative costs is not often clear and can be different from project to project.

For the trust fund, the appropriation language limiting administrative costs has evolved over the years as the Legislature has refined its requirements on this complicated issue. In the 2010 and 2011 appropriation laws,¹¹ the Legislature included the following language:

Money appropriated in this section may not be spent on activities unless they are directly related to the specific appropriation and are specified in the approved work program. Money appropriated in this section must not be spent on indirect costs or other institutional overhead charges.¹²

In the 2013 and 2014 appropriation laws, the Legislature expanded this language by adding:

Costs that are directly related to and necessary for an appropriation, including financial services, human resources, information services, rent and utilities, are eligible only if the costs can be clearly justified and individually documented specific to the appropriation's purpose and would not be generated by the recipient but for the receipt of the appropriation. No broad allocations for costs in either dollars or percentages are allowed.¹³

¹⁰ Administrative costs (also sometimes referred to as indirect or overhead costs) are costs associated with the general administration and daily operation of an entity. Examples include human resources, management services, financial services, information technology, and communications.

¹¹ The 2009 trust fund appropriation law was silent on the issue of limiting the use of trust fund money for administrative costs.

¹² *Laws of Minnesota* 2010, chapter 362, sec. 2, subd. 9 and *Laws of Minnesota* 2011, First Special Session, chapter 2, art. 3, sec. 2, subd. 11.

¹³ *Laws of Minnesota* 2013, chapter 52, sec. 2, subd. 9 and *Laws of Minnesota* 2014, chapter 226, sec. 2, subd. 11.

In applying these legal requirements to the entities that used money from the trust fund, we followed *Minnesota Statutes* 2015, 645.46, which provides guidance on interpreting and applying state law. It says, in part:

The object of all interpretation and construction of laws is to ascertain and effectuate the intention of the legislature. Every law shall be construed, if possible, to give effect to all its provisions. When the words of a law in their application to an existing situation are clear and free from all ambiguity, the letter of the law shall not be disregarded under the pretext of pursuing the spirit.¹⁴

We believe the language of this law is clear and “the letter of the law” must be applied. Therefore, we expect entities using money from the trust fund to be able to demonstrate that they used the money for costs that are “directly related to and necessary for” the purposes of the appropriation and that they have complied with statutory administrative cost limitations.

- **Money must be used to supplement not substitute for traditional sources of funding.** Entities must also show that they have complied with a requirement in state statutes that trust fund money “may not be used as a substitute for traditional sources of funding environmental and natural resources activities, but the trust fund shall supplement the traditional sources.”¹⁵

Unfortunately, the meaning of the “supplement not substitute” requirement is difficult to interpret since laws do not define what constitutes “traditional sources of funding.” We examined this question as it relates to use of money from the Legacy funds, in a 2011 program evaluation report.¹⁶ A key question that has not been answered is: How many years must an expense be funded from a particular revenue source for that source to be considered “traditional”?

The lack of clarity in these legal requirements makes it difficult for entities to comply and difficult for OLA to assess whether agencies complied. In our 2011 report related to the Legacy funds, we acknowledged that entities would need to put forth greater effort to justify and document how costs met requirements such as these. We believe that greater effort is what the law requires. Despite the challenges, we assessed entities’ compliance with these requirements during this audit.

¹⁴ *Minnesota Statutes* 2015, 645.16.

¹⁵ *Minnesota Statutes* 2014, 116P.03(a).

¹⁶ Office of the Legislative Auditor, Program Evaluation Division, *The Legacy Amendment*, November 2011, pages 45-53 (St. Paul, MN).

Conclusion

The Metropolitan Council did not have adequate internal controls over monitoring grant recipient use of money from the Environment and Natural Resources Trust Fund appropriations. The projects and grants we tested at the Metropolitan Council generally complied with significant finance-related legal requirements and used money from the Environment and Natural Resources Trust Fund appropriations in compliance with the legal purposes contained in the state constitution, state statutes, and appropriation laws. However, we found some costs that did not comply with specific legal requirements.

The Department of Natural Resources generally had adequate internal controls to ensure it used money from the Environment and Natural Resources Trust Fund appropriations for the intended purposes; however, the department had several weaknesses in internal controls. In addition, projects and grants we tested at the Department of Natural Resources generally complied with significant finance-related legal requirements and used money from the Environment and Natural Resources Trust Fund appropriations in compliance with the legal purposes contained in the state constitution, state statutes, and appropriation laws. However, we found some costs that did not comply with specific legal requirements.

The University of Minnesota had adequate internal controls to ensure that it used money from the Environment and Natural Resources Trust Fund appropriations for the intended purposes. In addition, the projects and grants we tested at the University of Minnesota complied with significant finance-related legal requirements and used money from the Environment and Natural Resources Trust Fund appropriations in compliance with the legal purposes contained in the state constitution, state statutes, and appropriation laws. However, the statutory requirement for how the state pays money from the trust fund to the university conflicts with the statutory requirement for investment of money in the trust fund.

The following *Findings and Recommendations* section provides further explanation about the exceptions noted above.

Findings and Recommendations

The Metropolitan Council did not have adequate internal controls and did not sufficiently monitor whether grant recipients used Environment and Natural Resources Trust Fund money in compliance with state laws.¹⁷

Finding 1

The Metropolitan Council did not adequately assess the risks related to the Park Acquisition Opportunity grant program and did not ensure it had adequate internal controls to address those risks. Through the Park Acquisition Opportunity grant program, the Metropolitan Council combined money from the Environment and Natural Resources Trust Fund with proceeds from the sale of the council's general obligation bonds to provide grants to the ten regional park implementing agencies for purchases of land.^{18, 19} The council required regional park implementing agencies to provide a 25 percent local match. Since the Legislature directed trust fund appropriations to the Metropolitan Council, we think the council has the responsibility to monitor the regional park implementing agencies' use of this money.

The council had not identified or assessed the risks related to noncompliance with state laws that could occur by the grant recipient (a regional park implementing agency) and had not developed controls to monitor grant recipients' compliance. The internal control framework being implemented by the council states that management "should identify, analyze, and respond to risks related to achieving its defined objectives"²⁰ The framework also states that management "should design control activities to achieve objectives and respond to risks."²¹

The council had assessed some risks, had many control activities in place, and had performed some activities to monitor the performance and effectiveness of those controls. However, without an adequate assessment of the risks and effective internal controls designed to address those risks over the grant program, the

¹⁷ We had a similar finding related to the Metropolitan Council's grants of money from the Parks and Trails Fund, one of the state's four Legacy funds. See Office of the Legislative Auditor, Financial Audit Division Report 16-04, *Parks and Trails Fund*, issued February 11, 2016, Finding 1.

¹⁸ The Metropolitan Council funds 60 percent of its Park Acquisition Opportunity grant program (about \$3.2 million) with money from the Environment and Natural Resources Trust Fund and 40 percent (or \$2.4 million) with money from the sale of Metropolitan Council bonds.

¹⁹ The ten regional park implementing agencies own and operate regional parks and trails in the Twin Cities Metropolitan Area. The regional park implementing agencies are Anoka County, City of Bloomington, Carver County, Dakota County, Minneapolis Parks & Recreation Board, Ramsey County, City of St. Paul, Scott County, Three Rivers Park District, and Washington County.

²⁰ Comptroller General of the United States, Government Accountability Office, *Standards for Internal Control in the Federal Government*, (Washington D.C., September 2014), page 37.

²¹ *Ibid.*, page 45.

council increased the chance that significant errors or noncompliance could occur without detection through its normal course of operations.

We tested all grants made to the regional park implementing agencies during fiscal years 2012 through 2015. The ten grants awarded \$6 million to six of the regional park implementing agencies; expenditures from these awards totaled about \$5.6 million through February 2015.

The council had the following deficiencies in its monitoring of these grants:

- The council did not have specific language in its grant agreements for some statutory and appropriation requirements related to the use of money from the trust fund.²² For example, the council did not include in the grant agreements the legal requirements for when money from the trust fund is used to acquire an interest in land. State statutes require the grant recipient to report land purchases to the Legislative-Citizen Commission on Minnesota Resources (the commission), record a notice of funding restrictions on the deed held by the county, and prepare a land restoration and management plan.²³ These actions help to ensure the continued use of the property for the purpose for which it was acquired. (Findings 2 and 3 identify specific noncompliance with legal requirements found through our testing.)
- The council did not obtain or review regional park implementing agencies' land appraisals and appraisal reviews to ensure the agencies planned to pay a reasonable price for the land.²⁴ (An appraisal is an opinion about the value of real property; an appraisal review is verification of the appraiser's qualifications and appraisal methods.)

Because the council did not have the information, we obtained from the regional park implementing agencies the appraisals and appraisal reviews related to the land purchases. We had the following concerns about the appraisals we reviewed:

- One appraisal was over three years old by the time the regional park implementing agency purchased the land.
- Another appraisal did not cover the entire acreage included in the land purchase.

²² *Minnesota Statutes* 2014, 116P, and *Laws of Minnesota* 2014, chapter 226.

²³ A notice of funding restrictions is a provision in a deed limiting or prohibiting certain uses of the land. The notice of funding restriction is recorded in the same local government office where the ownership transfer of the land is filed.

²⁴ A similar finding was also included in the Office of the Legislative Auditor Financial Audit Division Report 16-04, *Parks and Trails Fund*, issued February 4, 2016, Finding 1.

- In three cases, regional park implementing agencies paid more for land than the appraised values. Had the council reviewed the appraisals, it could have ensured there were legitimate reasons for the higher costs by requiring the regional park implementing agencies to provide justifications for their purchase prices.
- For eight of the ten land purchases, the regional park implementing agencies did not conduct an appraisal review to ensure the appraiser was qualified and used appropriate appraisal methods.

Legislative-Citizen Commission on Minnesota Resources' staff told us they were unaware that the council was not obtaining and reviewing appraisals or appraisal reviews. They told us they thought this was a fundamental level of oversight expected of the council when it granted money from the trust fund for land purchases.

- The council did not routinely visit regional park implementing agencies for the purpose of monitoring how the agencies administered the council's grants.²⁵ Without monitoring visits, the council did not have assurance, for example, that a regional park implementing agency's internal controls over land acquisitions were adequate, or that it had procedures in place to identify and avoid any conflicts of interest.

For state agencies, the state's Office of Grants Management requires at least one monitoring visit per grant period on all grants over \$50,000 and at least annual monitoring visits of grants over \$250,000.²⁶ While the policy is not applicable to the council, it sets a reasonable standard and expectation that monitoring visits are an important part of the oversight responsibilities of entities that grant public money.

These deficiencies increased the risk that regional park implementing agencies might use grant money inappropriately and not comply with grant agreements and state law. Findings 2 and 3 also identify deficiencies in the council's internal control procedures and specific instances of noncompliance with legal requirements.

Recommendations

- *The Metropolitan Council should clearly document and periodically review its risks and internal control activities related to its grant oversight responsibilities.*

²⁵ A similar finding was also included in the Office of the Legislative Auditor Financial Audit Division Report 16-04, *Parks and Trails Fund*, issued February 4, 2016, Finding 1.

²⁶ Department of Administration, Office of Grants Management, Operating Policy and Procedure Number: 08-10, *Policy on Grant Monitoring*.

- *The Metropolitan Council should include specific applicable legal requirements in its grant agreements with regional park implementing agencies.*
- *The Metropolitan council should develop procedures for reviewing appraisals to ensure regional park implementing agencies obtain current and complete appraisals that support the purchase price when acquiring land with money from the Environment and Natural Resources Trust Fund.*
- *The Metropolitan Council should conduct annual monitoring visits of the regional park implementing agencies.*

Finding 2

Land purchased by a Metropolitan Council grant recipient did not comply with legal requirements prohibiting the use of Environment and Natural Resources Trust Fund money for the purchase of residential structures.

Through its monitoring activities, the Legislative-Citizen Commission on Minnesota Resources questioned a May 2012 land purchase made by a regional park implementing agency with money from the trust fund (received through a grant from the Metropolitan Council.) The commission questioned the purchase (which used \$382,744 of trust fund money) because there were residential structures on the land. The regional park implementing agency allowed a portion of the grant to be used to pay for the removal of the residential structures after the purchase of the property. The appropriation law authorizing the use of trust fund money specifically stated, “This appropriation may not be used for the purchase of residential structures.”²⁷

In May 2014, commission staff sent a letter to the council requesting that it return the trust fund money used for the acquisition. In August 2014, the council sent a letter to the regional park implementing agency requesting the return of the money to comply with the commission staff’s request. When the agency did not return the money, the commission and the council asked the OLA to review whether the purchase was an allowable use of money from the trust fund.

We concluded that the purchase of the parcel containing the residential structures did not comply with the appropriation law and was a misuse of money from the Environment and Natural Resources Trust Fund.

Recommendation

- *The Metropolitan Council should work with the regional park implementing agency to return \$382,744 to the Environment and Natural Resources Trust Fund.*

²⁷ *Laws of Minnesota 2009, chapter 143, sec. 2, subd. 4(c).*

The Metropolitan Council did not ensure its grant recipients complied with a statute requiring entities to record a notice of funding restrictions when purchasing land with money from the Environment and Natural Resources Trust Fund.²⁸

Finding 3

State statutes require entities that acquire an interest in real property with trust fund money to record a notice of funding restrictions in the local government office where the ownership transfer of the land is filed.²⁹ According to the statutes the notice must contain: (1) a legal description of the land, (2) a reference to the underlying funding agreement (i.e., the appropriation language or grant agreement), (3) a reference to the statute, and (4) specific language included in the statute. Land purchased with money from seven of the ten grants we tested did not comply with the statute. For two of the seven grants, the regional park implanting agencies did not record a funding restriction notice. For five of the seven grants, the agencies recorded a notice but did not include a reference to the statute or the language required by the statute.

The notice protects the trust fund's interests; the land cannot be sold without the Legislative-Citizen Commission on Minnesota Resources' approval, and ownership of the land transfers to the state if the land is used in a way other than intended. Without a filed notice, it would be possible for the land to be sold and/or used for unintended purposes.

Recommendation

- *The Metropolitan Council should ensure regional park implementing agencies comply with state statutes requiring the recording of a notice of funding restrictions with the required language.*

The Department of Natural Resources could not show how administrative costs allocated to the Environment and Natural Resources Trust Fund complied with the requirement that all costs must be “directly related to and necessary for” specific projects or activities listed in the appropriation law.³⁰

Finding 4

The Department of Natural Resources developed a methodology to estimate and allocate administrative costs to the Environment and Natural Resources Trust

²⁸ A notice of funding restrictions is a provision in a deed limiting or prohibiting certain uses of the land. The notice of funding restriction is recorded in the same local government office where the ownership transfer of the land is filed.

²⁹ *Minnesota Statutes* 2014, 116P.15 subd. 2(c).

³⁰ We had a similar finding related to the Metropolitan Council's grants of money from the Parks and Trails Fund, one of the state's four Legacy funds. See Office of the Legislative Auditor, Financial Audit Division Report 16-04, *Parks and Trails Fund*, issued February 11, 2016, Finding 2.

Fund appropriations that was generally reasonable; however, the department could not show how this methodology limited the allocation of administrative costs to those that were directly related to and necessary for each specific appropriation.³¹

Over the last couple years the Legislature and the Legislative-Citizen Commission on Minnesota Resources have modified the appropriation language to clarify the “directly related to and necessary for” limitation on the use of trust fund money for administrative costs, adding:

Costs that are directly related to and necessary for an appropriation, including financial services, human resources, information services, rent and utilities, are eligible **only if the costs can be clearly justified and individually documented specific to the appropriation’s purpose and would not be generated by the recipient but for the receipt of the appropriation. No broad allocations for costs in either dollars or percentages are allowed.**³² [Emphasis added.]

In response to the changing language, the department reassessed its allocation methodology every year. Despite the department’s efforts to develop an allocation methodology that appropriately limits administrative costs charged to the trust fund, we believe the department did not achieve compliance.

The department used the following methodologies for its allocations of administrative costs:

- For two appropriations authorized by *Laws of Minnesota* 2011, the department used the same allocation methodology that it used for appropriations from other funds.³³ The department did not analyze individual administrative costs to ensure those costs were directly related to and necessary for the trust fund appropriations. We think the “directly related to and necessary for” language requires the department to analyze and document the direct relationship and necessity of the administrative costs to the specific appropriations. The department did not document how certain administrative costs, totaling \$505,390 for the two projects, met the requirement.

³¹ Administrative costs (also sometimes referred to as indirect or overhead costs) are costs associated with the general administration and daily operation of an entity. Examples include human resources, management services, financial services, information technology, and communications.

³² *Laws of Minnesota* 2013, chapter 52, sec. 2, subd. 9, and *Laws of Minnesota* 2014, chapter 226, sec. 2, subd. 11.

³³ The two appropriations are *Laws of Minnesota* 2011, First Special Session, chapter 2, art. 3, sec. 2, subd. 4(a) and 9(c). These two appropriations did not require commission oversight and submission of a work plan required by *Minnesota Statutes* 2014, 116P.05, subd 2(b).

- For appropriations authorized by *Laws of Minnesota* 2013, the department changed its allocation methodology for trust fund appropriations.³⁴ The department used a methodology that did not allocate administrative costs to appropriations that involved projects that they felt required fewer administrative resources.³⁵ However, for the appropriations to which it did allocate administrative costs, the department used a percentage allocation method. Its methodology used percentages to distribute cost pools to the various operating divisions in proportion to their use of the services.³⁶ The department had not documented its analysis to substantiate how the allocated costs directly benefited and were necessary for each specific appropriation. The law prohibited the use of “broad allocations for costs in either dollars or percentages.”
- For appropriations authorized by *Laws of Minnesota* 2014, the department used different methodologies to allocate division-level administrative costs and department-level administrative costs.³⁷ The allocation of division-level administrative costs continued to follow prior methodology, which continued to have the deficiencies noted in the previous bullet.

The allocation of department-level administrative costs, however, used a new methodology that correlated how a specific appropriation created incremental increases in specific administrative costs (such as human resources, procurement, financial, and computer services). We think the new department-level methodology sufficiently demonstrated how the department would not have generated these administrative costs but for the receipt of the appropriation from the trust fund.

- For 2012 through 2014 grants to recipients named in law, the department received an accompanying appropriation from the trust fund to cover the cost of administering these grants. The department charged costs to these appropriations using a rate that it applied to hours worked by employees to administer the grants. The rate the department developed included some administrative costs that the Legislative-Citizens Commission on Minnesota Resources had categorized as “ineligible unless otherwise authorized”, such as rent, out of state travel, and equipment usage. When

³⁴ *Laws of Minnesota* 2013, chapter 52.

³⁵ Examples of projects that require fewer administrative resources include: legislatively mandated grants (grants where the Legislature selects and specifically names the grant recipient in the appropriation law; the department does not need to go through the request for proposal process), land or easement acquisitions, or single-source contracts (contracts where only one company is available to fulfill the needs of the contract; the department does not need to go through the bidding process).

³⁶ The department is organized into seven divisions, including Land and Minerals, Ecological and Water Resources, Forestry, Parks and Trails, Fish and Wildlife, Enforcement, and Operations Services.

³⁷ *Laws of Minnesota* 2014, chapter 226.

requesting authority for these costs, the department did not adequately identify generally ineligible costs for the commission's specific authorization. Using these rates, the department charged costs totaling \$27,795 to the trust fund.

Department management told us they believe all administrative costs incurred by the department and its divisions are directly related to and necessary for the trust fund appropriations. They assert that the trust fund appropriations benefit from all administrative activities and that the trust fund appropriations should pay their fair share of the costs. Management believes the current allocation methodologies for trust fund appropriations actually cause the trust fund to pay less than its fair share and requires other funds to pay more for administrative costs. We disagree with the Department of Natural Resources' broad assertion because it does not provide the type of detailed analysis or documentation expected to ensure compliance.

In a 2011 report where we examined the "directly related to and necessary for" requirement for money spent from one of the state's Legacy funds, we acknowledged that it might be difficult for organizations to show how indirect costs meet the "directly related to and necessary for" test.³⁸ But, we also emphasized that agencies could not ignore this legal requirement. We acknowledged that justifying the use of money at a detailed level may require additional staff time. But, in our view, that greater level of effort and documentation is what the law requires. We think this expectation also holds true for entities that receive Environment and Natural Resources Trust Fund money. They must be able to show that all costs – including all administrative costs – charged to a trust fund appropriation are "directly related to and necessary for" the specific appropriation they received.

Further, department management stated that their allocation methodologies were reviewed by the Legislative-Citizen Commission on Minnesota Resources. However, we reviewed documentation of communications over several years between the department and the commission detailing the commission's efforts to get a clear explanation and understanding of the department's allocation methodologies and costs included in the rates used for certain appropriations.

Recommendation

- *The Department of Natural Resources should implement cost allocation policies and procedures that ensure that it only uses money from the Environment and Natural Resources Trust Fund for costs that are "directly related to and necessary for" the administration of trust fund projects and would not have been generated "but for the receipt of the appropriation."*

³⁸ Office of the Legislative Auditor, Program Evaluation Division, *The Legacy Amendment*, November 2011 (St. Paul, MN).

The statute governing how the state pays money appropriated from the Environment and Natural Resources Trust Fund to the University of Minnesota is in conflict with the statute governing the investment of trust fund money.

Finding 5

The state pays money appropriated from the trust fund to the University of Minnesota following a statute that requires the state to pay the university 1/12th of the appropriation each month.³⁹ This required payment schedule does not typically correspond to the university's use of the trust fund money, resulting in an accumulation by the university of unspent trust fund money. The university invests the unspent trust fund money along with its other investments, and credits any investment earnings to its overall investment accounts. As of the end of February 2015, the university held about \$17.7 million of unspent trust fund money in its investment accounts.⁴⁰

The statutory requirement governing the investment of the trust fund money states, "*All money earned by the trust fund must be credited to the trust fund.*"⁴¹ We think the state has a duty to reduce the time between when the money leaves the trust fund and when the university spends it, so that earnings to the trust fund can be maximized and added to the trust fund's balance for future appropriation by the Legislature. Alternatively, the university could return to the state income earned through investment of unspent money from the trust fund. These options require change to state statutes.

Recommendation

- *The Legislative-Citizen Commission on Minnesota Resources should consider a statutory change to:*
 - *Modify the state payment schedule for appropriations from the Environment and Natural Resources Trust Fund to the University of Minnesota so that payments more closely match the university's need for the money; or*
 - *Require the university to return to the trust fund any investment earning on unspent trust fund money.*

³⁹ *Minnesota Statutes* 2014, 137.025, subd. 1.

⁴⁰ The university's accumulated unspent trust fund balance has grown because appropriations to the university have increased (\$3.9 million for fiscal year 2013, \$11.8 million for fiscal year 2014, and \$17.7 million for fiscal year 2015) and because the projects for which the trust fund money was provided can span several years.

⁴¹ *Minnesota Statutes* 2014, 116P.04, subd. 1.

LEGISLATIVE-CITIZEN COMMISSION ON MINNESOTA RESOURCES

100 REV. DR. MARTIN LUTHER KING JR. BLVD.
ROOM 65 STATE OFFICE BUILDING
ST. PAUL, MINNESOTA 55155-1201

Phone: (651) 296-2406
Email: lccmr@lccmr.leg.mn
Web: www.lccmr.leg.mn
TTY: (651) 296-9896 or 1-800-657-3550

Susan Thornton, Director

February 5, 2016

Mr. James Nobles
Legislative Auditor
Office of the Legislative Auditor
Rm. 140 Centennial Building
658 Cedar Street
St. Paul, MN 55155

Dear Mr. Nobles,

This letter is in response to the letter and draft report sent to our office on February 1, 2016 from Cecile Ferkul, Deputy Legislative Auditor, regarding the results of the internal controls and compliance audit of the Environment and Natural Resources Trust Fund (ENRTF) for the period of from July 2012 through February 2015.

Regarding Finding 5 and the recommendation that the Legislative-Citizen Commission on Minnesota Resources (LCCMR) should consider a statutory change to "Modify the state payment schedule for appropriations from the Environment and Natural Resources Trust Fund to the University of Minnesota so that payments more closely match the university's need for the money; or Require the university to return to the trust fund any investment earning on unspent trust fund money," it is my responsibility as the Director of the LCCMR to bring this recommendation for a statutory change to the LCCMR for consideration as a recommendation to the MN Legislature in the 2016 legislative session. Minnesota Management and Budget (MMB) is the state agency responsible for the payments from these appropriations. The LCCMR will consult with MMB and the University on the most prudent statutory option to implement this recommendation.

Regarding Findings and Recommendations 1, 2, and 3 pertaining to the Metropolitan Council expenditures; over the past year, upon discovery of noncompliance of the state statutes cited, the staff of the LCCMR have been working with the Metropolitan Council staff to ensure retroactive and future compliance of the cited state statutes by recipients of the funding.

In addition, the LCCMR, after discovering that there had been acquisitions purchased with ENRTF dollars in amounts over 100% of the appraised value, adopted the following language that was incorporated into the 2015 and 2016 session laws applicable to the ENRTF funding appropriations:

"For any acquisition of lands or interest in lands, a recipient of money appropriated under this section shall not agree to pay more than 100 percent of the appraised value for a parcel of land using this money to complete the purchase, in part or in whole, except that up to ten percent above the appraised value may be allowed to complete the purchase, in part or in whole, using this money if permission is received in advance of the purchase from the Legislative-Citizen Commission on Minnesota Resources."

In response to this action by the LCCMR, the Metropolitan Council Parks and Open Space staff in consultation with LCCMR staff and the regional park implementing agencies, proposed a process and criteria to be used by the Council and regional park implementing agencies, to seek such a review by the LCCMR. This proposed process and criteria was presented to the LCCMR and incorporated into the Council work plan documents for the ENRTF.

Jeff Broberg, Sen. Gary Dahms, Sen. Kari Dziedzic, William Faber, Nancy Gibson, Rep. Tom Hackbarth, Bonnie Harper-Lore, John Hoffman, Gary Lamppa, Rep. Denny McNamara, Norman Moody, Rep. John Persell, Sen. David Tomassoni, Rep. Paul Torkelson, Rep. Jean Wagenius, Sen. Torrey Westrom, Della Young

LEGISLATIVE-CITIZEN COMMISSION ON MINNESOTA RESOURCES

Page 2

Regarding Finding 4 to the Department of Natural Resources, the LCCMR has and will continue to seek information of the cost allocation methodologies used by the Department.

On behalf of the LCCMR members and staff I want to thank the staff of the Office of the Legislative Auditor in conducting this audit of the Environment and Natural Resources Trust Fund.

Sincerely,

/s/ Susan Thornton

Susan A. Thornton
Director, LCCMR

CC: Cecile Ferkul, Deputy Legislative Auditor
LCCMR Co-Chairs Tomassoni, Persell, and Gibson

February 5, 2016

James Nobles
Legislative Auditor
Office of the Legislative Auditor
Room 140 Centennial Building
658 Cedar Street
Saint Paul, MN 55155-1603

RE: Environment and Natural Resources Trust Fund
Internal Controls and Compliance Audit

Dear Mr. Nobles,

We appreciate the opportunity to review and respond to the Internal Controls and Compliance Audit for the Environment and Natural Resources Trust Fund. We understand our oversight responsibility for Parks funding and have a long established, transparent grant award and approval process through the Metropolitan Parks and Open Space Commission, our Community Development Committee, and the full Metropolitan Council. We acknowledge the recommendations in the Legislative Auditors report strengthen our internal review and control processes.

As noted in the report, the Council uses funding from the Environment and Natural Resources solely for grants to regional parks implementing agencies for land acquisitions.

Finding 1: The Metropolitan Council did not have adequate internal controls and did not sufficiently monitor whether grant recipients used Environment and Natural Resources Trust Fund money in compliance with state laws.

Recommendations:

- *The Metropolitan Council should clearly document and periodically review its risks and internal control activities related to its grant oversight responsibilities.*
- *The Metropolitan Council should include specific applicable legal requirements in its grant agreements with regional park implementing agencies.*
- *The Metropolitan Council should develop procedures for reviewing appraisals to ensure regional park implementing agencies obtain current and complete appraisals that support the purchase price when acquiring land with money from the Environment and Natural Resources Trust Fund.*
- *The Metropolitan Council should conduct annual monitoring visits of the regional park implementing agencies.*

Response:

The Council's Program Evaluation and Audit Department conducts an annual Council-wide risk assessment and presents it to our Audit Committee. This assessment is the result of meetings with management from each of the Council's Divisions. An annual Audit Plan is developed based upon risks identified through this assessment. While each year grant specific internal audits are conducted in accord with our Audit Plan, we will enhance our risk assessment process to include identification and documentation of funding sources, changes in legislation, and staff responsible for grant oversight.

Parks program staff are reviewing and updating standard operating procedures for our parks grant programs with Council's Controller to assure adequate controls are in place and staff are effectively trained on grant oversight roles and responsibilities. For all new grant awards staff will utilize our new grants management system to track and document oversight activities, including appraisal reviews, and an appraisal summary now accompanies every business item recommending award of ENRTF grants. Previously awarded and active grants are also in process of conversion into our grants management system.

While Council staff have frequent contact with regional park implementing agencies at the monthly Metropolitan Parks and Open Space Commission meetings and routine interactions through regularly scheduled meetings and phone conversations, annual site visits focused on monitoring internal controls over grant administration will be incorporated into our overall parks grant program.

Grant agreement templates have been updated to include specific applicable legal requirements and staff are reviewing prior ENRTF grants to confirm compliance with provisions then in effect.

Person(s) Responsible/Expected Completion:

- Arlene Schilling - Director Program Evaluation and Audit – Risk Assessment to be completed in 2016 for our 2017 Audit Plan
- Emmett Mullin - Manager, Parks and Open Space; Marie Henderson - Controller – Review and update parks program standard operating procedures/site visits to be completed during 2016.

Finding 2: Land purchased by a Metropolitan Council grant recipient did not comply with legal requirements prohibiting the use of Environment and Natural Resources Trust Fund money for the purchase of residential structures.

Recommendation:

- *The Metropolitan Council should work with the regional park implementing agency to return \$382,744 to the Environment and Natural Resources Trust Fund.*

Response:

We agree, use of ENRTF grant funds by the regional park implementing agency to pay for removal of residential structures was an improper use and we requested repayment in August, 2014. Given the Legislative Auditor's concurrence of improper use, we will renew our request for the regional park implementing agency to return \$382,744 to the Council to repay ENRTF Fund.

Finding 3: The Metropolitan Council did not ensure its grant recipients complied with a statute requiring entities to record a notice of funding restrictions when purchasing land with money from the Environment and Natural Resource Trust Fund.

Recommendation:

- *The Metropolitan Council should ensure regional park implementing agencies comply with state statutes requiring the recording of notice of funding restrictions with the required language.*

Grant agreement templates have been updated to include specific applicable legal requirements, standard operating procedures are being updated to include confirmation of notice filing by the park implementation agency, and staff are reviewing prior ENRTF grants to confirm compliance with filing provisions then in effect.

Person Responsible/Expected Completion: Emmett Mullin - Manager, Parks and Open Space - June 2016.

Again, thank you for the opportunity to review and respond to the audit findings and recommendations for the Metropolitan Council.

Sincerely,

A handwritten signature in black ink, appearing to read "Mary Bogie".

Mary Bogie
Chief Financial Officer

Minnesota Department of Natural Resources

Office of the Commissioner
500 Lafayette Road • St. Paul, MN • 55155



February 3, 2016

Mr. James Nobles, Legislative Auditor
Office of the Legislative Auditor
Centennial Office Building, Room 140
658 Cedar Street
St. Paul, Minnesota 55155-1603

Dear Auditor Nobles:

RE: OLA Audit Report on Environment and Natural Resources Trust Fund Internal Controls and Compliance Audit, July 2012 through February 2015

Thank you for the opportunity to review and respond to the Office of Legislative Auditor's (OLA) findings and recommendations resulting from the recent audit of the Environment and Natural Resources Trust Fund (ENRTF). We appreciate the professional review conducted by the OLA audit.

The audit identified a number of the challenges state agencies face for funding administrative costs with ENRTF funds. These challenges include analyzing and documenting how costs are directly related to and necessary for the specific appropriation and how the department would not have generated these administrative costs but for the specific appropriation. It is important for the Department of Natural Resources (DNR) to demonstrate these costs as being eligible for funding within the ENRTF appropriations. Not being able to charge for administrative costs can lead to other programs, including programs funded with dedicated funds, paying a disproportionate share of the costs.

We have invested a lot of time and careful thought in creating operational orders, policies and guidelines for the ENRTF and other programs, to ensure fair distribution of administrative costs across all programs. We have been thoughtful and transparent in our approach, working extensively with the Legislative Citizen Commission on Minnesota Resources (LCCMR) to clarify and refine our processes to meet the commission requirements as well as legal requirements. We appreciate the report acknowledging this work and acknowledging that the current allocation methodology for department-wide administrative costs meets requirements of the appropriation.

We have made other changes to address the items outlined in the report regarding cost allocation methodologies used in fiscal years 12 through fiscal year 14, demonstrating our continued efforts to meet the ENRTF appropriation requirements, including:

- DNR is maintaining the formula used for Laws of 2014 for Laws of 2015.
- Beginning with the Laws of 2015 (fiscal year 2016), DNR has discontinued the use of division administration cost allocation.
- Beginning with the Laws of 2015 (fiscal year 2016), DNR has provided additional detail in the documentation on costs for grant administration hourly rates per LCCMR funding guidelines.

The final item outlined in the report was related to a one-time appropriation for operational activities. The appropriation was exempt from Minnesota Statutes 116P.05 Subdivision 2. We interpreted this exemption to allow for us to use our traditional cost allocation formula. If a similar appropriation is enacted in the future, we will work with the LCCMR and the Legislature to ensure clarity in the appropriation language.

The DNR offers the following specific responses regarding the audit finding and recommendation in the audit for the DNR:

Audit Finding

The Department of Natural Resources could not show how the administrative costs allocated to the Environment and Natural Resources Trust Fund complied with the “directly related to and necessary for” specific projects or activities listed in the appropriation law..

Audit Recommendation

The Department of Natural Resources should implement cost allocation policies and procedures that ensure that it uses money from the Environment and Natural Resources Trust Fund for costs that are “directly related to and necessary for” the administration of trust projects and would not have been generated “but for the receipt of the appropriation.”

DNR Response: We agree with the recommendation and consider it resolved. The current allocation formula for department administrative costs has been reviewed and approved by the LCCMR through our presentations and work plans and meets the current appropriation requirements. In addition, we will continue to include detailed costs for grant administration hourly rate costs, complying with the LCCMR funding guidelines. We look forward to the continued conversation with the LCCMR, Legislature, the OLA and MMB as issues arise to ensure clarity of requirements and appropriate implementation.

Sincerely,



Tom Landwehr
Commissioner

Copy: Cecile M. Ferkul, Deputy Legislative Auditor, OLA
Barb Juelich, Chief Financial Officer
Katie Shea, Internal Audit Manager

*Office of Vice President
and Chief Financial Officer
Treasurer*

Office of the President

*334B Morrill Hall
100 Church Street S.E.
Minneapolis, MN 55455*

*Office: 612-625-4517
Fax: 612-626-2278
Email: ubudget@umn.edu*

February 5, 2016

James Nobles, Legislative Auditor
State of Minnesota
Office of the Legislative Auditor
658 Cedar Street
Centennial Building 1st Floor
St Paul MN 55155

Re: Audit of the Environment and Natural Resources Trust Fund

Dear Mr. Nobles:

In response to Finding 5 of the above mentioned audit:

“The statute governing how the state pays money appropriated from the Environment and Natural Resources Trust Fund to the University of Minnesota is in conflict with the statute governing the investment of trust fund money.”

The University supports a statutory change to modify the state payment schedule for appropriations from the Environment and Natural Resources Trust Fund to the University of Minnesota (option one under the “recommendations” section of Finding 5). The University will work directly with Minnesota Management and Budget (MMB), and with any other state office that should be involved, to determine the most appropriate state payment schedule. The University has processes in place for handling the receipt of federal and private grants that share the same goal of timing the receipt of revenues with project spending requirements. These processes could be a model for developing the statutory change for the payments referred to in Finding 5, or we could modify them if necessary to accommodate specific requirements of the state. Either way, we believe changes could be accommodated that satisfy the recommendations in the audit. We will contact our budget officer in MMB to discuss next steps.

Sincerely,

Richard H. Pfutzenreuter

Richard H. Pfutzenreuter III
Vice President & Chief Financial Officer

