

PERFORMANCE AUDIT
OF
REAL ESTATE ACQUISITION AND DISPOSITION
DEPARTMENT OF NATURAL RESOURCES

April 2003



Michigan
Office of the Auditor General
REPORT SUMMARY

Performance Audit

Report Number:
75-155-02

Real Estate Acquisition and Disposition

Department of Natural Resources

Released:
April 2003

The Department of Natural Resources (DNR) is authorized by Section 324.503 of the Michigan Compiled Laws to accept gifts and grants of land and other property and may buy, sell, exchange, or condemn land and other property. DNR manages 4.5 million acres (12% of the total State land area) consisting of State forests, wildlife areas, parks and recreation areas, boating and fishing access sites, and land used for other purposes that benefit the public.

Audit Objective:

The objective of our performance audit was to assess the effectiveness of the DNR's administration of real estate sales, purchases, exchanges, easements, and leases.

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Audit Conclusion:

We concluded that DNR's administration of real estate sales, purchases, exchanges, easements, and leases was generally effective. However, our assessment disclosed reportable conditions related to contract management, lease records, trespass fees, and appraisals for large parcels of land.

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Reportable Conditions:

DNR should improve contract management by ensuring compliance with established procedures (Finding 1).

We found that DNR did not retain contracts for real estate appraisals, did not document its approval of contracts, did not enforce contract terms governing late submission of appraisals, and did not obtain required Department of Civil Service approval of appraisal contracts.

DNR did not maintain a comprehensive record of leases to which DNR is a party (Finding 2).

DNR management informed us that information on the number of leases and details regarding the leases is available only at each local field office.

DNR should improve its process for assessing and collecting trespass fees (Finding 3).

DNR accurately charged a trespass fee in only 1 of the 6 land transactions involving trespass in our review.

OPM should formalize and comply with its appraisal process for large parcels of land (Finding 4).

DNR did not contract for a second appraisal for any of the 3 land acquisition cases greater than \$500,000 in our review.

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Agency Response:

DNR's preliminary response indicated that it agreed with all of our recommendations.

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A copy of the full report can be obtained by calling 517.334.8050 or by visiting our Web site at: www.state.mi.us/audgen/



Michigan Office of the Auditor General
201 N. Washington Square
Lansing, Michigan 48913

Thomas H. McTavish, C.P.A.
Auditor General

James S. Neubecker, C.P.A., C.I.A., D.P.A.
Executive Deputy Auditor General

Scott M. Strong, C.P.A., C.I.A.
Director of Audit Operations



STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
FAX (517) 334-8079

THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

April 8, 2003

Mr. Keith J. Charters, Chairperson
Natural Resources Commission
and
Mr. K. L. Cool, Director
Department of Natural Resources
Stevens T. Mason Building
Lansing, Michigan

Dear Mr. Charters and Mr. Cool:

This is our report on the performance audit of Real Estate Acquisition and Disposition, Department of Natural Resources.

This report contains our report summary; description of process; audit objective, scope, and methodology and agency responses; comment, findings, recommendations, and agency preliminary responses; and a glossary of acronyms and terms.

The agency preliminary responses were taken from the agency's responses subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

We appreciate the courtesy and cooperation extended to us during this audit.

AUDITOR GENERAL

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Description of Process

As its mission*, the Department of Natural Resources (DNR) is committed to the conservation, protection, management, use, and enjoyment of the State's natural resources for current and future generations.

DNR is authorized by Section 324.503 of the *Michigan Compiled Laws* to accept gifts and grants of land and other property and may buy, sell, exchange, or condemn land and other property.

DNR is entrusted with the care of 4.5 million acres, 12% of the total State land area. The DNR-managed real estate consists of State forests, wildlife areas, parks and recreation areas, boating and fishing access sites, and land used for other purposes that benefit the public.

In April 2001, the Office of Property Management (OPM) was established within DNR, consolidating in one location responsibility for DNR facilities and facility planning with other DNR real estate functions. These functions include purchasing, selling, and exchanging State real estate; granting easements across State land; and selling tax-reverted property back to private ownership.

OPM had expenditures of \$7.6 million for fiscal year 2001-02 and 69 employees as of September 30, 2002.

* See glossary at end of report for definition.

Audit Objective, Scope, and Methodology and Agency Responses

Audit Objective

The objective of our performance audit* of Real Estate Acquisition and Disposition, Department of Natural Resources (DNR), was to assess the effectiveness* of DNR's administration of real estate sales, purchases, exchanges, easements, and leases.

Audit Scope

Our audit scope was to examine the program and other records of the Department of Natural Resources' real estate acquisition and disposition process. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Audit Methodology

Our audit procedures, conducted from April through September 2002, included examination of DNR's records and activities primarily for the period February 1, 2000 through July 31, 2002.

We conducted a preliminary review that consisted of interviewing management and program staff and reviewing legislation, the Department of Management and Budget Administrative Guide, the Office of Property Management (OPM) policies and procedures, and other OPM reports and manuals. The purpose of the preliminary review was to obtain an understanding of OPM operations and to plan our audit.

We tested management control* and procedures performed related to the selling and purchase of property and the granting of easements. We obtained sale and purchase data from individual transaction files and analyzed whether the services were performed in accordance with existing policies, procedures, laws, and regulations.

* See glossary at end of report for definition.

Agency Responses

Our audit report contains 4 findings and 4 corresponding recommendations. DNR's preliminary response indicated that it agreed with all of our recommendations.

The agency preliminary response that follows each recommendation in our report was taken from the agency's written comments and oral discussion subsequent to our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and Department of Management and Budget Administrative Guide procedure 1280.02 require DNR to develop a formal response to our audit findings and recommendations within 60 days after release of the audit report.

COMMENT, FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

REAL ESTATE ACQUISITION AND DISPOSITION

COMMENT

Audit Objective: To assess the effectiveness of the Department of Natural Resources' (DNR's) administration of real estate sales, purchases, exchanges, easements, and leases.

Conclusion: We concluded that DNR's administration of real estate sales, purchases, exchanges, easements and leases was generally effective. However, our assessment disclosed reportable conditions* related to contract management, lease records, trespass fees, and appraisals for large parcels of land.

FINDING

1. Contract Management

DNR should improve contract management by ensuring compliance with established procedures.

Our review of contracts noted:

- a. The Office of Property Management (OPM) did not retain contracts for real estate appraisals as required.

In our review of 33 land transaction files in which DNR contracted with an independent appraiser, 29 (88%) files did not contain a contract for the appraisal. We selected an additional sample of appraisal contracts for land transactions from September 2000 through December 2001. We noted that OPM did not retain contracts for 4 (67%) of the 6 additional files reviewed.

* See glossary at end of report for definition.

Department of Management and Budget General Schedule #6, Accounting and Purchasing Records, which relates to the retention and disposal of records, requires departments to retain all original contracts of State agencies for six years after their expiration. The contracts would be necessary to resolve any disputes that may arise with the contractors.

- b. DNR did not document its approval of contracts as required by written policy.

DNR Policy 212, Fee Appraisal Contracts, stipulates that the Real Estate Section supervisor, the Lands Division chief, and the bureau chief review and sign contracts awarded to appraisers. None of the 8 contracts that were present in the 39 land transaction files contained an approval signature.

Without written approval on the contract, there is no assurance that DNR management agreed with contract terms.

- c. DNR did not enforce contract terms governing late submission of appraisals.

All appraisal contracts require appraisers to submit their appraisals to OPM by specified dates. If an appraisal is submitted late, the appraisal contract allows DNR to either terminate the contract or deduct a penalty of 1% of the total fee for every business day the appraisal is late, unless the appraiser requests an extension in writing and the request is approved by DNR. Three (75%) of 4 appraisals in the 4 files containing contracts were submitted late. The appraisals ranged from 2 business days to 18 business days late. The due date for the fourth appraisal could not be determined from the contract. During our review of the files, we noted the contract due dates for 2 additional appraisals. These appraisals were 3 and 82 business days late, respectively. We noted no documents in the files for these 5 late appraisals requesting or approving time extensions. DNR paid each of these appraisal contractors 100% of the contracted amount.

Timely appraisals are necessary to facilitate decisions on property and are critical to property transactions.

- d. DNR did not obtain required Department of Civil Service (DCS) approval of appraisal contracts.

DNR Policy 212 requires a separate DCS contract when payments to an individual contractor exceed \$10,000 for a fiscal year. DCS gives DNR blanket approval for contract payments to appraisal contractors up to \$100,000 in each fiscal year. DCS requires approval of all contracts exceeding the \$100,000 aggregate limitation.

Based on a review of payments to appraisal contractors for fiscal years 1998-99 through 2001-02, we noted 22 appraisal contracts greater than \$10,000 that DNR did not submit to DCS for approval. We also noted that in all four fiscal years, OPM payments to appraisal contractors exceeded \$100,000. OPM did not complete and submit any contracts for DCS approval.

Lack of adherence to contract management procedures reduced OPM's ability to manage contracts for land transactions.

RECOMMENDATION

We recommend that DNR improve contract management by ensuring compliance with established procedures.

AGENCY PRELIMINARY RESPONSE

DNR agrees and will comply.

FINDING

2. Lease Records

DNR did not maintain a comprehensive record of leases to which DNR is a party.

DNR Procedure 2617.17 requires OPM to retain all original documents pertaining to State lands or interest in lands under the jurisdiction of or administrated by DNR. After preliminary contacts and negotiations, OPM must review the details for content, "hold harmless" clauses, recording requirements, legal responsibilities, and other technical details before incorporating them into a formal instrument. The responsibility for accepting and recording all such legal documents rests with OPM.

DNR management informed us that it did not know how many leases or what leases were outstanding. DNR management also informed us that information on the number of leases and details regarding the leases is available only at each

local field office. DNR has delegated the responsibility for the administration of the leasing process to the individual divisions. Since January 2000, when DNR formed an internal committee to review DNR leasing and real estate use arrangements, OPM has not been involved in the leasing process.

Allowing each division to administer its leases without having formal procedures could result in inconsistencies and inadequate protection of the State's interest.

RECOMMENDATION

We recommend that DNR maintain a comprehensive record of leases to which DNR is a party.

AGENCY PRELIMINARY RESPONSE

DNR agrees and will comply.

FINDING

3. Trespass Fees

DNR should improve its process for assessing and collecting trespass fees.

Section 324.504 of the *Michigan Compiled Laws* states that DNR shall promulgate rules for the protection of the lands and property under its control against wrongful use or occupancy.

In January 2000, OPM drafted Procedure 2612.12 to cover non-timber trespass on State lands (such as building structures and roads). However, it was never approved. OPM stated that it was enforcing the draft procedure. The procedure requires the party in trespass to remove any property built in trespass on State-owned land and restore the trespass site to its condition before the trespass occurred (remove buildings, roads, etc.). In extreme cases, the procedure allows DNR to sell or exchange the land to resolve the trespass situation. When this occurs, the procedure requires that the trespasser pay DNR a minimum of three times the fair market value of the land in trespass or three times the transaction cost, whichever is greater.

During our review of land dispositions, we noted 6 land transactions involving trespass and the sale or exchange of land. DNR accurately charged three times

the fair market value of the land to the trespass party in only 1 instance. Of the remaining 5 transactions, DNR determined the amount of damages in 1 case, but charged only two times that amount. In the remaining 4 transactions, DNR did not determine an amount of damages to assess.

Creating and enforcing strict trespass guidelines may help ensure that the State is adequately compensated for the wrongful use or occupancy of and diminished value of State-owned land.

RECOMMENDATION

We recommend that DNR improve its process for assessing and collecting trespass fees.

AGENCY PRELIMINARY RESPONSE

DNR agrees and will finalize and fully implement its Trespass Policy.

FINDING

4. Appraisals for Large Parcels of Land

OPM should formalize and comply with its appraisal process for large parcels of land.

DNR Policy 211 requires OPM to have an appraisal completed and the appraisal reviewed on all lands and rights bought and sold. OPM staff indicated that it is customary to obtain two independent appraisals for land transactions with initial estimated values that exceed \$500,000. Policy 211 also requires a review appraiser to review documentation in the depth and degree consistent with the dollar value of the property under consideration and the complexity of the appraisal problem.

OPM staff are required to solicit bids for independent appraisals, issue contracts for their completion, and review the appraisal reports as submitted. Although certified appraisers are required to follow uniform national standards, OPM staff stated that it is common for two appraisers, using acceptable procedures, to appraise the same property at different dollar values. As the size, complexity, and dollar value of a property transaction increase, the amount of a potential variation in appraised valuation increases. A second appraisal can provide additional insight and help

ensure that the State does not spend more than the fair market value for property and that the seller receives equitable compensation.

In our review of 21 land acquisition files, we noted 1 disposition greater than \$500,000 and 3 acquisitions greater than \$500,000 (\$730,000, \$750,000, and \$2,200,000). OPM obtained 2 certified appraisals for the disposition of the land parcel, but it did not contract for a second appraisal for any of the 3 acquisitions. In addition, for 1 of the acquisitions, OPM accepted a land appraisal provided by the private owner in lieu of contracting for a separate appraisal. Further, OPM did not complete an appraisal review as required by DNR Policy 211.

Requiring the submission of two appraisals and a thorough appraisal review for large parcels of land helps ensure that DNR maintains public confidence.

RECOMMENDATION

We recommend that OPM formalize and comply with its appraisal process for large parcels of land.

AGENCY PRELIMINARY RESPONSE

DNR agrees and will comply.

Glossary of Acronyms and Terms

| | |
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| DCS | Department of Civil Service. |
| DNR | Department of Natural Resources. |
| effectiveness | Program success in achieving mission and goals. |
| management control | The plan of organization, methods, and procedures adopted by management to provide reasonable assurance that goals are met; resources are used in compliance with laws and regulations; valid and reliable data is obtained and reported; and resources are safeguarded against waste, loss, and misuse. |
| mission | The agency's main purpose or the reason that the agency was established. |
| OPM | Office of Property Management. |
| performance audit | An economy and efficiency audit or a program audit that is designed to provide an independent assessment of the performance of a governmental entity, program, activity, or function to improve public accountability and to facilitate decision making by parties responsible for overseeing or initiating corrective action. |
| reportable condition | A matter that, in the auditor's judgment, represents either an opportunity for improvement or a significant deficiency in management's ability to operate a program in an effective and efficient manner. |