



# MICHIGAN

OFFICE OF THE AUDITOR GENERAL

## AUDIT REPORT



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

The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof.

– Article IV, Section 53 of the Michigan Constitution

Audit report information can be accessed at:

*<http://audgen.michigan.gov>*



Michigan  
*Office of the Auditor General*  
**REPORT SUMMARY**

*Financial Audit*  
*Including the Provisions of the Single Audit Act*

Report Number:  
 751-0100-08

*Department of Natural Resources*

*October 1, 2005 through September 30, 2007*

Released:  
 January 2009

*A Single Audit is designed to meet the needs of all financial report users, including an entity's federal grantor agencies. The audit determines if the financial schedules and/or financial statements are fairly presented; considers internal control over financial reporting and internal control over federal program compliance; determines compliance with requirements material to the financial schedules and/or financial statements; and assesses compliance with direct and material requirements of the major federal programs.*

***Financial Statements and Financial Schedules:***

**Auditor's Reports Issued**

We issued unqualified opinions on the Department of Natural Resources' (DNR's) financial statements and financial schedules.

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**Internal Control Over Financial Reporting**

We identified a significant deficiency in internal control over financial reporting (Finding 1). We do not consider this significant deficiency to be a material weakness.

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**Noncompliance and Other Matters  
 Material to the Financial Statements  
 and/or Financial Schedules**

We did not identify any instances of noncompliance applicable to the financial statements and/or financial schedules that are required to be reported under *Government Auditing Standards*.

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***Federal Awards:***

**Auditor's Reports Issued on Compliance**

We audited 6 programs as major programs and reported known questioned costs of \$2,706,279 and known and likely questioned costs totaling \$2,775,034. DNR expended a total of \$81.7 million in federal awards during the two-year period ended September 30, 2007. We issued 4 unqualified opinions and 2 qualified opinions. The opinions issued by major program are identified on the back of this summary.

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**Internal Control Over Major Programs**

We identified significant deficiencies in internal control over federal program compliance (Findings 2 through 7). We consider Findings 5 and 7 to contain material weaknesses.

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**Required Reporting of Noncompliance**

We identified instances of noncompliance that are required to be reported in accordance with U.S. Office of Management and Budget (OMB) Circular A-133 (Findings 2 through 7).

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**Systems of Accounting and Internal Control:**

We determined that DNR was in substantial compliance with Sections 18.1483 - 18.1487 of the *Michigan Compiled Laws*.

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We audited the following programs as major programs:

<u>CFDA Number</u>	<u>Program or Cluster Title</u>	<u>Compliance Opinion</u>
10.664	Cooperative Forestry Assistance	Unqualified
10.665	Schools and Roads - Grants to States	Unqualified
15.605 and 15.611	Fish and Wildlife Cluster	Unqualified
15.634	State Wildlife Grants	Qualified
15.916	Outdoor Recreation - Acquisition, Development and Planning	Unqualified
97.012	Boating Safety Financial Assistance	Qualified

A copy of the full report can be obtained by calling 517.334.8050 or by visiting our Web site at: <http://audgen.michigan.gov>



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Lansing, Michigan 48913

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

**Scott M. Strong, C.P.A., C.I.A.**  
Deputy Auditor General



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

January 28, 2009

Mr. Keith J. Charters, Chair  
Natural Resources Commission  
and  
Ms. Rebecca A. Humphries, Director  
Department of Natural Resources  
Stevens T. Mason Building  
Lansing, Michigan

Dear Mr. Charters and Ms. Humphries:

This is our report on the financial audit, including the provisions of the Single Audit Act, of the Department of Natural Resources (DNR) for the period October 1, 2005 through September 30, 2007.

This report contains our report summary, our independent auditor's reports on the financial statements and on the financial schedules, and the DNR financial statements and financial schedules and supplemental financial statements and schedules. This report also contains our independent auditor's report on internal control over financial reporting and on compliance and other matters, our independent auditor's report on compliance with requirements applicable to each major program and on internal control over compliance in accordance with U.S. Office of Management and Budget Circular A-133, and our schedule of findings and questioned costs. In addition, this report contains DNR's summary schedule of prior audit findings, its corrective action plan, and a glossary of acronyms and terms.

Our findings and recommendations are contained in Section II and Section III of the schedule of findings and questioned costs. The agency preliminary responses are contained in the corrective action plan. 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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INDEPENDENT AUDITOR'S REPORTS,  
FINANCIAL STATEMENTS, AND  
FINANCIAL SCHEDULES



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

## Independent Auditor's Report on the Financial Statements

Mr. Keith J. Charters, Chair  
Natural Resources Commission  
and  
Ms. Rebecca A. Humphries, Director  
Department of Natural Resources  
Stevens T. Mason Building  
Lansing, Michigan

Dear Mr. Charters and Ms. Humphries:

We have audited the accompanying financial statements of the Department of Natural Resources as of and for the fiscal years ended September 30, 2007 and September 30, 2006, as identified in the table of contents. These financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1, the financial statements present only the special revenue, permanent, and capital projects funds administered by the Department of Natural Resources and do not purport to, and do not, present fairly the financial position of the State of Michigan or its special revenue, permanent, and capital projects funds as of September 30, 2007 and September 30, 2006 and the changes in financial position thereof for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Department of Natural Resources' funds as of September 30, 2007 and September 30, 2006 and the changes in financial position for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 30, 2008 on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The schedule of expenditures of federal awards, required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and the supplemental financial statements, as identified in the table of contents, are presented for purposes of additional analysis and are not a required part of the Department's financial statements referred to in the first paragraph. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

AUDITOR GENERAL

December 30, 2008



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THOMAS H. MCTAVISH, C.P.A.  
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## Independent Auditor's Report on the Financial Schedules

Mr. Keith J. Charters, Chair  
Natural Resources Commission  
and  
Ms. Rebecca A. Humphries, Director  
Department of Natural Resources  
Stevens T. Mason Building  
Lansing, Michigan

Dear Mr. Charters and Ms. Humphries:

We have audited the accompanying financial schedules of the Department of Natural Resources for the fiscal years ended September 30, 2007 and September 30, 2006, as identified in the table of contents. These financial schedules are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial schedules based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial schedules. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1, the financial schedules present only the revenues and other financing sources and the sources and disposition of authorizations for the Department of Natural Resources' General Fund accounts, presented using the current financial resources measurement focus and the modified accrual basis of accounting. Accordingly, these financial schedules do not purport to, and do not, constitute a complete financial presentation of either the Department or the State's General Fund in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial schedules referred to in the first paragraph present fairly, in all material respects, the revenues and other financing sources and the sources and disposition of authorizations of the Department of Natural Resources for the fiscal years ended September 30, 2007 and September 30, 2006 on the basis of accounting described in Note 1.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 30, 2008 on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The schedule of expenditures of federal awards, required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, is presented for purposes of additional analysis and is not a required part of the Department's financial schedules referred to in the first paragraph. Such information has been subjected to the auditing procedures applied in the audit of the financial schedules and, in our opinion, is fairly stated, in all material respects, in relation to the financial schedules taken as a whole.

AUDITOR GENERAL

December 30, 2008

DEPARTMENT OF NATURAL RESOURCES  
Combined Balance Sheet  
As of September 30, 2007  
(In Thousands)

	Governmental Fund Types			Totals
	Special Revenue Funds	Permanent Funds	Capital Projects Fund	
<b>ASSETS</b>				
Cash	\$ 232	\$	\$	\$ 232
Equity in common cash (Note 4)	176,889	289,514	2,010	468,413
Taxes, interest, and penalties receivable	191			191
Securities lending collateral (Note 4)	56,534	174,350		230,883
Amounts due from other funds	754			754
Amounts due from federal agencies	701			701
Inventories	284			284
Other current assets	6,904	12,598		19,501
Investments - Long-term (Notes 3 and 4)	75,875	303,949		379,824
	<u>318,363</u>	<u>780,409</u>	<u>2,010</u>	<u>\$ 1,100,782</u>
<b>Total assets</b>	<b>\$ 318,363</b>	<b>\$ 780,409</b>	<b>\$ 2,010</b>	<b>\$ 1,100,782</b>
<b>LIABILITIES AND FUND BALANCES</b>				
<b>Liabilities:</b>				
Warrants outstanding	\$ 1,166	\$ 424	\$	\$ 1,590
Accounts payable and other liabilities	15,359	16,500		31,859
Obligations under security lending (Note 4)	56,534	174,350		230,883
Amounts due to other funds	20,716	52		20,768
Deferred revenue	667			667
<b>Total liabilities</b>	<b>\$ 94,441</b>	<b>\$ 191,326</b>	<b>\$ 0</b>	<b>\$ 285,767</b>
<b>Fund balances:</b>				
<b>Reserves for:</b>				
<b>Budgetary carry-forwards:</b>				
Encumbrances	\$ 11,703	\$ 15,316	\$	\$ 27,018
Restricted revenues (Note 5)	30,597	3,093		33,690
Multi-year projects	31,427	51,400		82,827
Funds held as permanent investments (Note 3)	118,904	477,414		596,318
<b>Total reserved</b>	<b>\$ 192,630</b>	<b>\$ 547,223</b>	<b>\$ 0</b>	<b>\$ 739,853</b>
Unreserved	31,291	41,860	2,010	75,162
<b>Total fund balances</b>	<b>\$ 223,921</b>	<b>\$ 589,084</b>	<b>\$ 2,010</b>	<b>\$ 815,015</b>
	<u>318,363</u>	<u>780,409</u>	<u>2,010</u>	<u>\$ 1,100,782</u>
<b>Total liabilities and fund balances</b>	<b>\$ 318,363</b>	<b>\$ 780,409</b>	<b>\$ 2,010</b>	<b>\$ 1,100,782</b>

The accompanying notes are an integral part of the financial statements.

DEPARTMENT OF NATURAL RESOURCES  
 Combined Balance Sheet  
 As of September 30, 2006  
 (In Thousands)

	Governmental Fund Types			Totals
	Special Revenue Funds	Permanent Funds	Capital Projects Fund	
<b>ASSETS</b>				
Cash	\$ 190	\$	\$	\$ 190
Equity in common cash (Note 4)	99,472	137,772	1,906	239,149
Taxes, interest, and penalties receivable	232			232
Securities lending collateral (Note 4)	33,191	137,295		170,486
Amounts due from federal agencies	960			960
Inventories	228			228
Other current assets	6,355	12,680		19,036
Investments - Long-term (Notes 3 and 4)	107,711	423,434		531,145
	<u>\$ 248,339</u>	<u>\$ 711,181</u>	<u>\$ 1,906</u>	<u>\$ 961,426</u>
<b>Total assets</b>				
<b>LIABILITIES AND FUND BALANCES</b>				
Liabilities:				
Warrants outstanding	\$ 383	\$ 357	\$	\$ 740
Accounts payable and other liabilities	13,132	16,621		29,753
Obligations under security lending (Note 4)	33,191	137,295		170,486
Amounts due to other funds	1,125	69		1,194
Deferred revenue	529	1,330		1,859
<b>Total liabilities</b>	<u>\$ 48,360</u>	<u>\$ 155,672</u>	<u>\$ 0</u>	<u>\$ 204,032</u>
Fund balances:				
Reserves for:				
Budgetary carry-forwards:				
Encumbrances	\$ 16,008	\$ 10,826	\$	\$ 26,835
Restricted revenues (Note 5)	12,972			12,972
Multi-year projects	29,478	44,343		73,821
Funds held as permanent investments (Note 3)	110,709	454,758		565,468
<b>Total reserved</b>	<u>\$ 169,167</u>	<u>\$ 509,927</u>	<u>\$ 0</u>	<u>\$ 679,094</u>
Unreserved	30,812	45,582	1,906	78,300
<b>Total fund balances</b>	<u>\$ 199,979</u>	<u>\$ 555,509</u>	<u>\$ 1,906</u>	<u>\$ 757,394</u>
<b>Total liabilities and fund balances</b>	<u>\$ 248,339</u>	<u>\$ 711,181</u>	<u>\$ 1,906</u>	<u>\$ 961,426</u>

The accompanying notes are an integral part of the financial statements.

DEPARTMENT OF NATURAL RESOURCES  
 Combined Statement of Revenues, Expenditures, and Changes in Fund Balances  
Fiscal Year Ended September 30, 2007  
 (In Thousands)

	Governmental Fund Types			Totals
	Special Revenue Funds	Permanent Funds	Capital Projects Fund	
<b>REVENUES</b>				
Taxes	\$ 304	\$	\$	\$ 304
From federal agencies	4,788			4,788
From licenses and permits	112,129			112,129
Miscellaneous (Notes 4 and 9)	58,274	97,445	111	155,830
Total revenues	<u>\$ 175,495</u>	<u>\$ 97,445</u>	<u>\$ 111</u>	<u>\$ 273,051</u>
<b>EXPENDITURES</b>				
Current	\$ 172,510	\$ 15,359	\$ 6	\$ 187,875
General government	2,668	8,528		11,195
Capital outlay	9,659	20,109		29,768
Total expenditures	<u>\$ 184,837</u>	<u>\$ 43,995</u>	<u>\$ 6</u>	<u>\$ 228,839</u>
Excess of revenues over (under) expenditures	<u>\$ (9,342)</u>	<u>\$ 53,450</u>	<u>\$ 104</u>	<u>\$ 44,212</u>
<b>OTHER FINANCING SOURCES (USES)</b>				
Proceeds from sale of capital assets	\$	\$ 29	\$	\$ 29
Transfers from other funds (Note 1)	121,394	10,000		131,394
Transfers to other funds (Note 1)	(107,939)	(10,076)		(118,015)
Total other financing sources (uses)	<u>\$ 13,455</u>	<u>\$ (46)</u>	<u>\$ 0</u>	<u>\$ 13,409</u>
Excess of revenues and other sources over (under) expenditures and other uses	<u>\$ 4,113</u>	<u>\$ 53,403</u>	<u>\$ 104</u>	<u>\$ 57,621</u>
Fund balances - Beginning of fiscal year - Restated (Notes 1 and 2)	<u>219,809</u>	<u>535,680</u>	<u>1,906</u>	<u>757,394</u>
Fund balances - End of fiscal year	<u><u>\$ 223,921</u></u>	<u><u>\$ 589,084</u></u>	<u><u>\$ 2,010</u></u>	<u><u>\$ 815,015</u></u>

The accompanying notes are an integral part of the financial statements.

DEPARTMENT OF NATURAL RESOURCES  
 Combined Statement of Revenues, Expenditures, and Changes in Fund Balances  
Fiscal Year Ended September 30, 2006  
 (In Thousands)

	Governmental Fund Types			Totals
	Special Revenue Funds	Permanent Funds	Capital Projects Fund	
<b>REVENUES</b>				
Taxes	\$ 332	\$	\$	\$ 332
From federal agencies	3,043			3,043
From licenses and permits	101,076			101,076
Miscellaneous (Notes 4 and 9)	49,875	80,540	91	130,506
Total revenues	<u>\$ 154,326</u>	<u>\$ 80,540</u>	<u>\$ 91</u>	<u>\$ 234,958</u>
<b>EXPENDITURES</b>				
Current	\$ 153,717	\$ 15,933	\$ 3	\$ 169,654
General government	356	1,477		1,833
Capital outlay	9,830	35,217	125	45,172
Total expenditures	<u>\$ 163,904</u>	<u>\$ 52,627</u>	<u>\$ 128</u>	<u>\$ 216,659</u>
Excess of revenues over (under) expenditures	<u>\$ (9,578)</u>	<u>\$ 27,914</u>	<u>\$ (37)</u>	<u>\$ 18,299</u>
<b>OTHER FINANCING SOURCES (USES)</b>				
Proceeds from sale of capital assets	\$	\$ 123	\$	\$ 123
Transfers from other funds	25,829	10,000		35,829
Transfers to other funds	(14,470)	(10,079)		(24,549)
Total financing sources	<u>\$ 11,359</u>	<u>\$ 44</u>	<u>\$ 0</u>	<u>\$ 11,403</u>
Excess of revenues and other sources over (under) expenditures and other uses	<u>\$ 1,782</u>	<u>\$ 27,957</u>	<u>\$ (37)</u>	<u>\$ 29,702</u>
Fund balances - Beginning of fiscal year	<u>198,197</u>	<u>527,552</u>	<u>1,943</u>	<u>727,692</u>
Fund balances - End of fiscal year	<u>\$ 199,979</u>	<u>\$ 555,509</u>	<u>\$ 1,906</u>	<u>\$ 757,394</u>

The accompanying notes are an integral part of the financial statements.

DEPARTMENT OF NATURAL RESOURCES  
Schedule of General Fund Revenues and Other Financing Sources  
Fiscal Year Ended September 30, 2007  
(In Thousands)

REVENUES	
From federal agencies	\$ 35,666
From services	1,475
From licenses and permits (Note 2)	180
Miscellaneous	2,088
Total revenues	<u>\$ 39,408</u>
OTHER FINANCING SOURCES	
Proceeds from sale of capital assets	<u>\$ 1,583</u>
Total other financing sources	<u>\$ 1,583</u>
Total revenues and other financing sources	<u><u>\$ 40,990</u></u>

The accompanying notes are an integral part of the financial schedules.

DEPARTMENT OF NATURAL RESOURCES  
 Schedule of General Fund Revenues and Other Financing Sources  
Fiscal Year Ended September 30, 2006  
 (In Thousands)

REVENUES	
From federal agencies	\$ 37,295
From services	1,287
From licenses and permits (Note 2)	11,205
Miscellaneous	4,215
Total revenues	<u>\$ 54,001</u>
OTHER FINANCING SOURCES	
Transfers from Michigan Transportation Fund	\$ 3,604
Proceeds from sale of capital assets	1,026
Total other financing sources	<u>\$ 4,630</u>
Total revenues and other financing sources	<u><u>\$ 58,630</u></u>

The accompanying notes are an integral part of the financial schedules.

DEPARTMENT OF NATURAL RESOURCES  
 Schedule of Sources and Disposition of General Fund Authorizations  
Fiscal Year Ended September 30, 2007  
 (In Thousands)

<b>SOURCES OF AUTHORIZATIONS (Note 6)</b>	
General purpose appropriations	\$ 31,790
Balances carried forward	23,761
Restricted financing sources	41,146
Less: Intrafund expenditure reimbursements	<u>(635)</u>
Total	<u><u>\$ 96,061</u></u>
 <b>DISPOSITION OF AUTHORIZATIONS (Note 6)</b>	
Gross expenditures and transfers out	\$ 92,968
Less: Intrafund expenditure reimbursements	<u>(635)</u>
Net expenditures and transfers out	<u>\$ 92,332</u>
Balances carried forward:	
Encumbrances	\$ 77
Restricted revenues - not authorized or used	<u>3,512</u>
Total balances carried forward	<u>\$ 3,590</u>
Balances lapsed	<u>\$ 139</u>
Total	<u><u>\$ 96,061</u></u>

The accompanying notes are an integral part of the financial schedules.

DEPARTMENT OF NATURAL RESOURCES  
 Schedule of Sources and Disposition of General Fund Authorizations  
Fiscal Year Ended September 30, 2006  
 (In Thousands)

SOURCES OF AUTHORIZATIONS (Note 6)	
General purpose appropriations	\$ 25,943
Balances carried forward	25,695
Restricted financing sources	58,113
Less: Intrafund expenditure reimbursements	<u>(771)</u>
Total	<u><u>\$ 108,981</u></u>
DISPOSITION OF AUTHORIZATIONS (Note 6)	
Gross expenditures and transfers out	\$ 85,482
Less: Intrafund expenditure reimbursements	<u>(771)</u>
Net expenditures and transfers out	<u>\$ 84,711</u>
Balances carried forward:	
Encumbrances	\$ 270
Restricted revenues - not authorized or used	<u>23,491</u>
Total balances carried forward	<u>\$ 23,761</u>
Balances lapsed	<u>\$ 509</u>
Total	<u><u>\$ 108,981</u></u>

The accompanying notes are an integral part of the financial schedules.

## Notes to the Financial Statements and Financial Schedules

### Note 1 Significant Accounting Policies

#### a. Reporting Entity - Financial Statements

The accompanying financial statements report the financial position and the changes in financial position of the following funds administered by the Department of Natural Resources (DNR) as of and for the fiscal years ended September 30, 2007 and September 30, 2006:

#### Special Revenue Funds

Fiscal Year 2006-07	Fiscal Year 2005-06
Michigan Conservation and Recreation Legacy Fund	Game and Fish Protection Fund
Michigan Game and Fish Protection Trust Fund	Michigan State Waterways Fund
Combined Recreation Bond Fund - Local Projects	Marine Safety Fund
Michigan Nongame Fish and Wildlife Trust Fund	Game and Fish Protection Trust Fund
Michigan Civilian Conservation Corps Endowment Fund	State Park Improvement Fund
Forest Development Fund	Combined Recreation Bond Fund - Local Projects
	Michigan Nongame Fish and Wildlife Fund
	Forest Development Fund

#### Permanent Funds

Fiscal Year 2006-07	Fiscal Year 2005-06
Michigan Natural Resources Trust Fund	Michigan Natural Resources Trust Fund
Michigan State Parks Endowment Fund	Michigan State Parks Endowment Fund
	Michigan Civilian Conservation Corps Endowment Fund

#### Capital Projects Fund

Fiscal Year 2006-07	Fiscal Year 2005-06
Combined Recreation Bond Fund - State projects	Combined Recreation Bond Fund - State projects

These funds are a part of the State of Michigan's reporting entity and are reported on in the *State of Michigan Comprehensive Annual Financial Report (SOMCAFR)*.

During the fiscal year ended September 30, 2007, certain changes were made to the fund structure of the DNR funds:

- (1) The Michigan Conservation and Recreation Legacy Fund (Legacy Fund) was created by a constitutional amendment approved by voters in November 2006. The implementing legislation transferred the following special revenue funds into the new Legacy Fund: Game and Fish Protection Fund, Michigan State Waterways Fund, Marine Safety Fund, and State Park Improvement Fund. The legislation also transferred the following restrictively financed activities into the new Legacy Fund: snowmobiles, off-road vehicles, recreation trails, and State forest recreation. More information regarding the creation of this fund can be found in Note 2, Accounting Changes and Restatements.
- (2) The Michigan Civilian Conservation Corps Endowment Fund was classified as a permanent fund in fiscal year 2005-06 and was reclassified as a special revenue fund type because of Act 147, P.A. 2007. More information regarding this change can be found in Note 2, Accounting Changes and Restatements.

b. Reporting Entity - Financial Schedules

The accompanying financial schedules report the results of DNR's General Fund financial transactions for the fiscal years ended September 30, 2007 and September 30, 2006.

c. Measurement Focus, Basis of Accounting, and Presentation

The financial statements and financial schedules contained in this report are presented using the current financial resources measurement focus and the modified accrual basis of accounting as provided by accounting principles generally accepted in the United States of America (GAAP). Under the modified accrual basis of accounting, revenues are recognized as they become susceptible to accrual, generally when they are both measurable and available. Revenues are considered to be available when they are collected within the current period or soon enough thereafter to pay liabilities of the current period. Expenditures generally are recorded when a liability is incurred; however, certain expenditures

related to long-term obligations are recorded only when payment is due and payable.

The accompanying financial statements present only the funds listed in Note 1a. Accordingly, they do not purport to, and do not, present fairly the financial position and changes in financial position of the State of Michigan or its special revenue funds, permanent funds, and capital projects funds in conformity with GAAP.

The accompanying financial schedules present only the revenues and other financing sources and the sources and disposition of authorizations for DNR's General Fund accounts. Accordingly, these financial schedules do not purport to, and do not, constitute a complete financial presentation of either DNR or the State's General Fund in conformity with GAAP.

The *SOMCAFR* provides more extensive disclosures regarding the State's significant accounting policies; budgeting, budgetary control, and legal compliance; common cash; pension benefits and other postemployment benefits; deposits and investments; and interfund receivables and payables.

The financial transactions of DNR are recorded in the General Fund and in individual funds in the State's central accounting system. The various natural resource funds are combined in the *SOMCAFR* into governmental fund types described as follows:

Special Revenue Funds: This fund group includes operating fund activities financed by specific revenue sources that are legally restricted for specified purposes.

Permanent Funds: This fund group reports resources that are legally restricted to the extent that only earnings, and not principal, may be used for purposes that benefit the government or its citizenry, such as State park preservation.

Capital Projects Funds: This fund group accounts for the acquisition or construction of major State capital facilities financed by bond proceeds and commercial paper notes.

Note 2 Accounting Changes and Restatements

The Legacy Fund was created by Article IX, Section 40 of the State Constitution, an amendment approved by voters in November 2006. The implementing legislation related to this amendment, found in Sections 324.2002 - 324.2035 of the *Michigan Compiled Laws*, transferred a number of special revenue funds and certain restrictively financed activities within the General Fund to the Legacy Fund. The following special revenue funds were transferred into the Legacy Fund: Game and Fish Protection Fund, Michigan State Waterways Fund, Marine Safety Fund, and State Park Improvement Fund. The restrictively financed activities transferred into the Legacy Fund from the General Fund were related to various outdoor recreation activities, including snowmobiles, off-road vehicles, recreation trails, and State forest recreation. The former General Fund activities accounted for approximately \$11 million in license and permit revenue in the Legacy Fund in fiscal year 2006-07.

The Michigan Civilian Conservation Corps Endowment Fund, formerly reported as a permanent fund, was reclassified as a special revenue fund type because of Act 147, P.A. 2007, which required the transfer of \$20 million from the Michigan Civilian Conservation Corps Endowment Fund to the General Fund. The transfer eliminated the reserve for permanent investment previously maintained in the Michigan Civilian Conservation Corps Endowment Fund.

The effect of this change as of October 1, 2006 was to decrease permanent fund current assets (\$8.9 million), long-term investments (\$19.0 million), current liabilities (\$8.0 million), and fund balances (\$19.8 million). Special revenue fund assets, liabilities, and fund balances were increased by like amounts.

Note 3 Funds Restricted for Investments

By constitutional provision or statute, certain revenues have been restricted for the purpose of generating investment revenue and are not available for current spending. The balance sheet amounts on the line under "Fund balances" entitled "Reserves for funds held as permanent investments" include corpus amounts plus or minus amounts related to undistributed investment gains or losses. The State Treasurer is responsible for managing these investments. The State Treasurer, by agreement with DNR, invests available revenues.

DNR provides asset allocation recommendations to the State Treasurer with respect to amounts to be held in the form of fixed income and equity portfolios. DNR also implemented distribution plans for the various funds to determine when the fair value gains or losses are made available for program appropriation and spending.

Equities: Beginning in fiscal year 2002-03 for the Michigan Natural Resources Trust Fund and in fiscal year 2004-05 for all other funds with equity investments, DNR implemented investment distribution plans based upon a fixed distribution of earnings (for example, 5% of the equities portfolio). Excess earnings are retained in revenue stabilization reserves to be used in years when actual returns are less than that percentage. Prior to that time, only realized gains or losses were recognized for distribution purposes. All equity investments have been in the form of market index mutual funds.

Fixed income: For fixed income portfolios, except for the Michigan Natural Resources Trust Fund, distributions of earnings are based upon interest income, plus or minus gains and losses realized upon redemption. This is based upon the assumption of DNR and past practice of the Michigan Department of Treasury that these investments will generally be held to maturity (unless called) for the purpose of generating interest. Because this portfolio is not actively traded, fair value gains and losses are considered temporary and distribution is based upon interest income.

Note 4 Deposits and Investments

DNR's deposits and investments are managed by the State Treasurer. DNR's deposits are included in the State of Michigan's common cash pool. "Equity in common cash" represents an interest in the State's common cash pool, which is used by many State funds as a short-term investment vehicle. All DNR funds are included in the common cash pool. The investment authority for the common cash pool is found in Sections 21.141 - 21.147 of the *Michigan Compiled Laws*. DNR also has the following account and funds that held

investments and earned investment income during fiscal years 2006-07 and 2005-06:

Fiscal Year 2006-07	Fiscal Year 2005-06
Game and Fish Protection Account	Game and Fish Protection Fund
Michigan Game and Fish Protection Trust Fund	Game and Fish Protection Trust Fund
Michigan Nongame Fish and Wildlife Trust Fund	Michigan Nongame Fish and Wildlife Fund
Michigan Civilian Conservation Corps Endowment Fund	Michigan Natural Resources Trust Fund
Michigan Natural Resources Trust Fund	Michigan State Parks Endowment Fund
Michigan State Parks Endowment Fund	Michigan Civilian Conservation Corps Endowment Fund

a. Common Cash Deposits

	As of September 30	
	2007	2006
Equity in common cash:		
Special revenue funds	\$176,888,991	\$ 99,471,533
Permanent funds	\$289,513,537	\$137,772,155
Capital projects fund	\$ 2,010,051	\$ 1,905,591

Governmental accounting and financial reporting standards require certain disclosures related to custodial credit risk and foreign currency risk for deposits. Custodial credit risk for deposits is the risk that, in the event of a depository financial institution failure, DNR's deposits may not be recovered. Deposits are exposed to custodial credit risk if they are not covered by depository insurance and are uncollateralized, collateralized with securities held by the pledging financial institution, or collateralized with securities held by the pledging financial institution's trust department or agent but not in the DNR fund's name. The State Treasurer's policy requires the following criteria to lessen the custodial credit risk: (1) all financial institutions holding the State's money must pledge collateral equal to the amount of the account balance for all demand and time deposits to secure the State funds; (2) a bank, savings and loan association, or credit union holding State funds must be organized under the law of Michigan or federal law and maintain a principal office or branch office in the State of Michigan; and (3) no deposit in any financial organization may be in excess of 50% of the net worth of the organization.

Foreign currency risk for deposits is the risk that changes in exchange rates will adversely affect the fair value of deposits. Section 487.714 of the *Michigan Compiled Laws* requires State deposits to be held in a financial institution that maintains a principal office or branch office located in the State of Michigan. The State had no common cash deposits subject to foreign currency risk at September 30, 2007 and September 30, 2006.

b. Investments

Governmental accounting and financial reporting standards also require disclosures for investments for interest rate risk, custodial credit risk, credit risk, foreign currency risk, and concentration of credit risk:

- (1) Interest rate risk: Interest rate risk is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. The State Treasurer's policy states that cash equivalents are invested in short-term fixed income securities with an average weighted maturity of less than one year to provide liquidity and safety of principal from capital market and default risk. The State Treasurer does not have a policy regarding interest rate risk for long-term debt investments.

As of September 30, 2007, the average maturities of investments were as follows:

Investment Type	Fair Value	Investment Maturities			
		Less Than 1 Year	1 to 5 Years	6 to 10 Years	More Than 10 Years
Special revenue funds:					
Mutual funds *	\$	\$	\$	\$	\$
Corporate bonds	13,409,067		5,843,850	6,150,030	1,415,187
Government securities	62,465,886		21,560,531	33,604,697	7,300,659
Permanent funds:					
Mutual funds *					
Corporate bonds	111,207,076		28,144,165	48,384,062	34,678,848
Government securities	192,741,482		76,354,894	86,009,122	30,377,465
Total investments	<u>\$ 379,823,511</u>	<u>\$ 0</u>	<u>\$131,903,440</u>	<u>\$174,147,911</u>	<u>\$73,772,159</u>

\* In fiscal year 2006-07, DNR's mutual funds were sold.

As of September 30, 2006, the average maturities of investments were as follows:

Investment Type	Fair Value	Investment Maturities			
		Less Than 1 Year	1 to 5 Years	6 to 10 Years	More Than 10 Years
Special revenue funds:					
Mutual funds *	\$ 52,697,065	\$	\$	\$	\$
Corporate bonds	7,728,727		4,325,157	2,792,769	610,800
Government securities	47,285,689		7,659,660	33,242,798	6,383,231
Permanent funds:					
Mutual funds *	107,565,888				
Corporate bonds	116,018,698		29,149,283	41,418,579	45,450,836
Government securities	199,849,084		29,196,130	120,906,765	49,746,189
Total investments	\$531,145,151	\$ 0	\$70,330,230	\$198,360,911	\$102,191,056

\* Mutual funds have no fixed income or duration and, therefore, are not segmented for time.

- (2) Custodial credit risk: Custodial credit risk for investments is the risk that, in the event of a failure of the counterparty to a transaction, the DNR funds will not be able to recover the value of their investments or collateral securities that are in the possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the State on behalf of the DNR funds, and are held either by the counterparty or by the counterparty's trust department or agent but not in the State's name. All investments of the DNR funds were insured or registered or were held by the State or its agent in the State's name. The State Treasurer does not have a policy for limiting custodial credit risk.
- (3) Credit risk: Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. All long-term fixed income investments, unless unrated, must be investment grade at the time of purchase, unless specific requirements are met. Investment grade, as defined in Section 38.1132c of the *Michigan Compiled Laws*, includes investments in the top four major grades as

determined by two national rating services. The State Treasurer's policy is to use Standard & Poor's (AAA, AA, A, BBB) and Moody's Investors Service (Aaa, Aa, A, Baa).

As of September 30, 2007, the credit quality ratings of debt securities were as follows:

Investment Type	Fair Value	Standard & Poor's	Fair Value	Moody's Investors Service
Special revenue funds:				
Corporate bonds	\$ 9,956,825	AAA	\$ 9,956,825	Aaa
	1,647,714	A	1,647,714	A
	1,804,528	BBB	1,804,528	Baa
Government securities - U.S. agencies	60,563,248	AAA	60,563,248	Aaa
	1,902,638	Unrated	1,902,638	Unrated
Permanent funds:				
Corporate bonds	63,068,780	AAA	54,875,936	Aaa
	5,868,223	AA	4,422,427	Aa
	41,123,321	A	50,761,961	A
	1,146,751	BBB	1,146,751	Baa
Government securities - U.S. agencies	171,760,330	AAA	171,760,330	Aaa
	20,981,152	Unrated	20,981,152	Unrated
Total	\$379,823,510		\$379,823,510	

As of September 30, 2006, the credit quality ratings of debt securities were as follows:

Investment Type	Fair Value	Standard & Poor's	Fair Value	Moody's Investors Service
Special revenue funds:				
Corporate bonds	\$ 6,469,878	AAA	\$ 6,469,878	Aaa
	841,964	A	841,964	A
	416,885	BBB	416,885	Baa
Government securities - U.S. agencies	47,285,689	AAA	47,285,689	Aaa
Permanent funds:				
Corporate bonds	57,605,977	AAA	57,605,977	Aaa
	13,931,627	AA	4,485,837	Aa
	42,026,205	A	51,471,995	A
	2,454,889	BBB	2,454,889	Baa
Government securities - U.S. agencies	190,304,217	AAA	190,304,217	Aaa
	9,544,867	Unrated	9,544,867	Unrated
Total	<u>\$370,882,198</u>		<u>\$370,882,198</u>	

- (4) Foreign currency risk: Foreign currency risk for investments is the risk that changes in exchange rates will adversely affect the fair value of investments. As of September 30, 2007 and September 30, 2006, the DNR funds did not have any investments in foreign securities.
- (5) Concentration of credit risk: Concentration of credit risk is the risk of loss attributable to the magnitude of DNR's investments with a single

issuer. As of September 30, 2007, DNR had the following investments that represent 5% or more of total investments:

Name of Issuer	Amount	Percent of Investments
Special revenue funds:		
Federal Home Loan Bank	\$ 37,906,516	50%
Federal Farm Credit Bank	\$ 18,331,706	24%
General Electric Capital Corporation	\$ 5,843,850	8%
Permanent funds:		
Federal Home Loan Bank	\$ 95,273,281	31%
Federal Farm Credit Bank	\$ 64,531,041	21%
General Electric Capital Corporation	\$ 30,658,913	10%
Government National Mortgage Association - Mortgage backed securities	\$ 20,981,152	7%
Toyota Motor Credit	\$ 17,687,486	6%

As of September 30, 2006, DNR had the following investments that represent 5% or more of total investments:

Name of Issuer	Amount	Percent of Investments
Special revenue funds:		
Vanguard Institutional Index Fund - Institutional shares	\$ 51,620,903	48%
Federal Home Loan Bank	\$ 28,761,102	27%
Federal Farm Credit Bank	\$ 17,641,371	16%
Permanent funds:		
Federal Home Loan Bank	\$105,972,660	25%
Vanguard Institutional Index Fund - Institutional shares	\$101,690,088	24%
Federal Farm Credit Bank	\$ 69,157,401	16%
General Electric Capital Corporation	\$ 31,806,220	8%

c. Securities Lending Transactions

The State Treasurer uses DNR investment funds to participate in a security lending program. Under the authority of Section 38.1133 of the *Michigan Compiled Laws*, the State lends securities to broker-dealers and other entities for collateral that will be returned for the same securities in the future. The custodian of the securities is not liable for any losses unless there is negligence or willful misconduct on its part. State statutes allow the State to participate in securities lending transactions, via a securities lending authorization agreement, authorizing the agent bank to lend its securities to broker-dealers and banks, pursuant to a form of loan agreement.

During both fiscal years, the agent bank, at the direction of the State Treasurer, lent securities of the DNR funds and received cash (United States and foreign currency), securities issued or guaranteed by the United States government, sovereign debt rated A or better, convertible bonds, Canadian provincial debt, and irrevocable bank letter of credit as collateral. The agent bank did not have the ability to pledge or sell collateral securities delivered absent a borrower's default. Borrowers were required to deliver collateral for each loan equal to: 1) in the case of loaned securities denominated in United States dollars or whose primary trading market was located in the United States or sovereign debt issued by foreign governments, 102% of the fair value of the loaned securities; or 2) in the case of loan securities not denominated in United States dollars or whose primary trading market was not located in the United States, 105% of the fair value of the loaned securities.

The State Treasurer did not impose any restrictions during either fiscal year on the amount of the loans that the agent bank made on its behalf. The agent bank indemnified the State by agreeing to purchase replacement securities or return cash collateral in the event that the borrower failed to return loaned securities or pay distributions thereon. There were no such failures by any borrower during either fiscal year. Moreover, there were no losses during either fiscal year resulting from a default of the borrowers or agent bank.

During both fiscal years, the State Treasurer and the borrowers maintained the right to terminate all securities lending transactions on

demand. The cash collateral received on each loan was invested in a collective investment pool along with the cash collateral of other qualified and nonqualified tax-exempt plan lenders. As of September 30, 2007 and September 30, 2006, the investment pool had an average duration of 25 days and 22 days, respectively, and an average expected maturity of 710 days and 678 days, respectively. Because the loans were terminable at will, their duration did not generally match the duration of the investments made with cash collateral. At September 30, 2007 and September 30, 2006, the DNR funds had no credit risk exposure from borrowers. The collateral held and the fair value of securities on loan for DNR special revenue and permanent funds were as follows:

	As of September 30	
	2007	2006
Special revenue funds:		
Collateral held	\$ 56,533,701	\$ 33,191,394
Fair value	\$ 55,377,288	\$ 32,569,423
Permanent funds:		
Collateral held	\$174,349,741	\$137,295,050
Fair value	\$170,783,370	\$134,722,290

d. Unrealized Investment Gain/(Loss)

DNR's investment balances at year-end include unrealized gains and losses. DNR's unrealized investment income decreased by \$9,725,348 for special revenue funds and by \$17,063,131 for permanent funds in fiscal year 2006-07 and increased by \$3,730,878 for special revenue funds and by \$4,049,463 for permanent funds in fiscal year 2005-06 to reflect the change in fair value of investments.

Note 5 Fund Balance Reserves for Restricted Revenues

The line entitled "Restricted revenues" under "Fund balances: Reserves for budgetary carry-forwards" for special revenue funds on the combined balance

sheet includes the following fund balances (in thousands) reserved for specific purposes:

September 30, 2007		September 30, 2006	
<u>Michigan Conservation and Recreation Legacy Fund</u>		<u>Game and Fish Protection Fund</u>	
Deer Habitat Improvement	\$ 3,539	Deer Habitat Improvement	\$ 5,588
Fisheries Settlement	2,286	Fisheries Settlement	2,079
Wildlife Resource Protection	553	Wildlife Resource Protection	233
Waterfowl Fees	2,107	Waterfowl Fees	1,900
Turkey Program	1,954	Turkey Program	2,118
Youth Hunting and Fishing Education Outreach	219	Youth Hunting and Fishing Education Outreach	289
Pittman-Robertson Program	760	Pittman-Robertson Program	697
Dingell-Johnson Program	71	Dingell-Johnson Program	68
Marine Safety Program	670		
Pittman-Robertson Hunter Education Program	223		
Forest Recreation Account	200		
Recreation Improvement Account	1,959		
Off-Road Vehicle Trail Improvement	6,148		
ORV Safety Education	294		
Snowmobile Registration Fees	680		
Snowmobile Trail Improvement	8,934		
	<hr/>		<hr/>
Total restricted revenue reserves	<u>\$30,597</u>	Total restricted revenue reserves	<u>\$ 12,972</u>

The fiscal year 2006-07 increase of restricted revenue reserves was primarily a result of the creation of the Michigan Conservation and Recreation Legacy Fund, which now restricts the use of the Forest Recreation Account, Recreation Improvement Account, Off-Road Vehicle Trail Improvement, ORV Safety Education, Snowmobile Registration Fees, and Snowmobile Trail Improvement funds (see Note 1a).

**Note 6 Schedule of Sources and Disposition of General Fund Authorizations**

The various elements of the schedule of sources and disposition of General Fund authorizations are defined as follows:

- a. General purpose appropriations: Original appropriations and any supplemental appropriations that are financed by General Fund/general purpose revenues.
- b. Balances carried forward: Authorizations for multi-year projects, encumbrances, restricted revenues - authorized, and restricted revenues - not authorized or used that were not spent as of the end of the

prior fiscal year. These authorizations are available for expenditure in the current fiscal year for the purpose of the carry-forward without additional legislative authorization, except for the restricted revenues - not authorized or used.

- c. Restricted financing sources: Collections of restricted revenues and restricted transfers, net of restricted intrafund expenditure reimbursements, to finance programs as detailed in the appropriations act. These financing sources are authorized for expenditure up to the amount appropriated. Depending upon program statute, any amounts received in excess of the appropriation are, at year-end, either converted to general purpose financing sources and made available for general appropriation in the next fiscal year or carried forward to the next fiscal year as either restricted revenues - authorized or restricted revenues - not authorized or used. Significant sources for DNR in fiscal year 2006-07 included \$17.5 million in federal fish and wildlife restoration funds, \$7.7 million in federal homeland security funds, and \$6.5 million in federal forest service funds. Significant sources for DNR in fiscal year 2005-06 included \$20.0 million in federal fish and wildlife restoration funds, \$8.3 million in snowmobile trail improvement funds, \$6.5 million in federal forest service funds, \$4.9 million in federal homeland security funds, \$4.2 million in federal national park service funds, and \$3.2 million in off-road vehicle trail improvement funds.
- d. Intrafund expenditure reimbursements: Funding from other General Fund departments to finance a program or a portion of a program that is the responsibility of the receiving department.
- e. Encumbrances: Authorizations carried forward to finance payments for goods or services ordered during the fiscal year but not received by fiscal year-end. These authorizations are generally limited to obligations funded by general purpose appropriations.
- f. Restricted revenues - not authorized or used: Revenues that, by statute, are restricted for use to a particular program or activity. Generally, the expenditure of the restricted revenues is subject to annual legislative appropriation. Significant carry-forwards of this type in fiscal year 2006-07 were \$1.1 million of aircraft fees and \$735,000 of private funds.

Significant carry-forwards of this type in fiscal year 2005-06 were \$9.8 million of snowmobile trail improvement fees and \$6.0 million of off-road vehicle trail improvement fees.

- g. Balances lapsed: Authorizations that were unexpended or unobligated at the end of the fiscal year. These amounts are available for legislative appropriation in the subsequent fiscal year.

Note 7 Interfund Commitments

In fiscal year 2002-03, Act 746, P.A. 2002, required the transfer of \$7.8 million from the Michigan State Waterways Fund to the General Fund. The Act states that, in the future, the General Fund is to provide reimbursement. Interfund receivables and payables are not recorded for this commitment because there is no repayment schedule and the repayment is considered long-term and budgetary in nature.

Note 8 Resolved Litigation

DNR is a party to various legal proceedings seeking damages or injunctive or other relief. The following litigations were resolved during the audit period:

- a. *Comben v State of Michigan*: Plaintiff Antrim County Treasurer sought a declaratory ruling whether owners of severed oil and gas interests were entitled to notice of tax foreclosures under the new tax foreclosure process adopted in Section 211.78 of the *Michigan Compiled Laws*. The trial court held that under the general property tax act, the severance tax act, and the dormant minerals act, severed oil and gas rights are not subject to taxation and foreclosure. The Court of Appeals affirmed as to the severance tax act and the dormant minerals act. The Supreme Court vacated the Court of Appeals decision on the basis that the State was not affected by the trial court decision and lacked standing to appeal.
- b. *Black Stone Minerals Co v State of Michigan*: A quiet title class action, severed from *Comben v State of Michigan*, seeks to quiet title to oil and gas rights acquired by the State by tax foreclosure after the oil and gas rights were severed from the surface ownership. The action was combined with a court of claims class action, with the same parties, seeking damages for severed oil and gas interests sold by the State after tax foreclosure. The State holds approximately 5.9 million acres of

mineral rights, the vast majority of which were acquired by tax foreclosure. The trial court held that under the general property tax act, the severance tax act, and the dormant minerals act, severed oil and gas rights are not subject to taxation and foreclosure. The plaintiff originally projected as many as 250,000 acres of the State's oil and gas ownership were severed before tax foreclosure. Trial on the quiet title action was completed in 2006, with less than 7,000 acres of oil and gas rights claimed by the State determined to have been severed before tax foreclosure. The settlement agreement reached between the parties was approved by the 13th Circuit Court in July 2007.

Note 9 Subsequent Events

In 1997, the State sold certain natural gas production to a third party in order to capture certain tax credits (Section 29 of the Internal Revenue Code) being offered by the federal government. Under the provisions of the sale agreement, after a certain level of production was reached, the State forwarded all revenues to the buyer. That level of production was reached as of July 1, 2005. The agreement further stipulated that after a second level of future production was reached ("full production"), the revenues would revert back to the State from the first day of the month following the full production date.

During the period October 1, 2005 through September 30, 2007, the State forwarded to the buyer \$49.6 million of revenues attributed to the generated production. In November 2007, full production was reached and, therefore, in accordance with the sale agreement, the revenues would revert back to the State beginning December 1, 2007. Past monthly average gas royalty revenues paid to the buyer were approximately \$2.0 million.

**SUPPLEMENTAL FINANCIAL  
STATEMENTS AND SCHEDULE**



## Descriptions of Special Revenue Funds

### MICHIGAN CONSERVATION AND RECREATION LEGACY FUND

The Legacy Fund was created by Article IX, Section 40 of the State Constitution, an amendment approved by voters in November 2006. The purpose of the amendment was to constitutionally prevent the diversion of certain funds and revenues for purposes other than those for which they were created. Section 40 created the following accounts within the Legacy Fund: Forest Recreation, Game and Fish Protection, Off-Road Vehicle, Recreation Improvement, Snowmobile, State Park Improvement, and Waterways.

The implementing legislation related to this amendment, found in Sections 324.2002 - 324.2035 of the *Michigan Compiled Laws*, transferred a number of special revenue funds and certain restrictively financed activities within the General Fund to the Legacy Fund. The following special revenue funds were transferred into the Legacy Fund: Game and Fish Protection Fund, Michigan State Waterways Fund, Marine Safety Fund, and State Park Improvement Fund. The restrictively financed activities transferred into the Legacy Fund from the General Fund were related to various outdoor recreation activities, including snowmobiles, off-road vehicles, recreation trails, and State forest recreation.

Financing consists primarily of hunting and fishing licenses; camping and park entrance fees; 2% of gasoline taxes dedicated for boating, snowmobiling, off-road vehicles, and other trails; watercraft and snowmobile registration fees; and trail use permits. The Legacy Fund also receives funding from the Michigan Game and Fish Protection Trust Fund. Expenditures are limited to those activities specified in Section 40 and include forest recreation activities, wildlife and fisheries programs, off-road vehicle and snowmobile trails and facilities, State parks and recreation areas, improvement of lake harbors and inland waterways, and water safety education programs.

### GAME AND FISH PROTECTION FUND

Established in 1921, this Fund operates under Sections 324.43546, 324.43553, 324.43556, and 324.43557 of the *Michigan Compiled Laws* and is financed principally by the sale of hunting and fishing licenses. The license fees are set by statute and their purpose is to support the conservation program for preservation and control of fish and wildlife. The Fund also receives funding from the Game and Fish Protection Trust Fund. The Fund provides financial support for Statewide hunting and fishing programs,

including resource management, research, enforcement of hunting and fishing laws, and acquisition of lands to be used for hunting and fishing purposes.

Article IX, Section 40 of the State Constitution, an amendment approved by voters in November 2006, created the Game and Fish Protection Account within the new Michigan Conservation and Recreation Legacy Fund. As required by Section 324.2010 of the *Michigan Compiled Laws*, the fund balance in this Fund was transferred to the new account during fiscal year 2006-07.

#### MICHIGAN STATE WATERWAYS FUND

Established in 1947, this Fund operates under Sections 324.78105, 324.78110, 324.78111, and 324.78115 of the *Michigan Compiled Laws*. The Fund receives portions of watercraft registration fees and gasoline taxes, some of which are collected by other State agencies and transferred to this Fund. The Fund provides for improvement of lake harbors and inland waterways; construction, operation, and maintenance of recreational boating facilities; property acquisition; and administration.

In fiscal year 2002-03, Section 1602, Act 746, P.A. 2002, required the transfer of \$7.8 million from this fund to the General Fund. Section 1602(3) states that "It is the intent of the legislature that in the future the General Fund reimburse the State Waterways Fund." No receivable is recorded in this Fund for this commitment because there is no repayment schedule and the repayment is considered long-term and budgetary in nature.

Article IX, Section 40 of the State Constitution, an amendment approved by voters in November 2006, created the Waterways Account within the new Michigan Conservation and Recreation Legacy Fund. As required by Section 324.2035 of the *Michigan Compiled Laws*, the fund balance in this Fund was transferred to the new account during fiscal year 2006-07.

#### MARINE SAFETY FUND

Established in 1967, this Fund operates under Sections 324.44511, 324.44518, 324.80115, 324.80118, and 324.80119 of the *Michigan Compiled Laws*. The Fund is financed principally by 49% of watercraft registration fees imposed by this law. The Fund provides for water safety education programs, law enforcement, and regulation of watercraft on the waters of this State.

Article IX, Section 40 of the State Constitution, an amendment approved by voters in November 2006, created the Waterways Account within the new Michigan Conservation and Recreation Legacy Fund. As required by Section 324.2035 of the *Michigan Compiled Laws*, the fund balance in this Fund was transferred to the new account during fiscal year 2006-07.

#### MICHIGAN GAME AND FISH PROTECTION TRUST FUND (formerly known as the Game and Fish Protection Trust Fund)

The former Game and Fish Protection Trust Fund was established in 1986 to restrict certain assets for the purpose of generating interest and earnings for transfer to the former Game and Fish Protection Fund (now accounted for within the Michigan Conservation and Recreation Legacy Fund). Article IX, Section 41 of the State Constitution, an amendment approved by voters in November 2006, further protected these assets by creating the Michigan Game and Fish Protection Trust Fund.

The Fund operates under Sections 324.43702 - 324.43704 of the *Michigan Compiled Laws*. The Legislature may appropriate up to \$6 million annually for use by the Game and Fish Protection Account of the Michigan Conservation and Recreation Legacy Fund. Mineral royalties from lands acquired by the Game and Fish Protection Account; direct sale proceeds; and other revenues, which, by statute, are retained for permanent investment, provide additional investment funding.

#### STATE PARK IMPROVEMENT FUND

Established in 1960, this Fund operates under Section 324.74108 of the *Michigan Compiled Laws*. The Fund is primarily financed by State park use and concession fees and motor vehicle permit fees necessary for entry by motor vehicles into designated State parks. These fees are the primary funding source for the operation, maintenance, debt service, and improvements of the State park system. Revenues of this Fund are pledged as necessary for repayment of State Park Gross Revenue Bonds.

Article IX, Section 40 of the State Constitution, an amendment approved by voters in November 2006, created the State Park Improvement Account within the new Michigan Conservation and Recreation Legacy Fund. As required by Section 324.2030 of the *Michigan Compiled Laws*, the fund balance in this Fund was transferred to the new account during fiscal year 2006-07.

## COMBINED RECREATION BOND FUND - LOCAL PROJECTS

Established in 1988, this Fund operates under Sections 324.19606 - 324.19612, 324.19615, 324.71303, and 324.71506 - 324.71508 of the *Michigan Compiled Laws*. The residual balances in this Fund reflect proceeds and investment earnings remaining from two bond packages: \$70 million of general obligation bonds approved by voters in November 1988, as part of a \$140 million bond package for financing State and local public recreation projects, and \$50 million of general obligation bonds approved by voters in November 1998, as part of a \$675 million bond package known as the "Clean Michigan Initiative."

Proceeds from the 1988 bond package provide grants and loans to local units of government in the amounts of \$65 million for local recreation projects and \$5 million to discourage development of open space and underdeveloped lands. Proceeds from the 1998 bond package also provided grants to local units of government for local recreation projects pursuant to Section 324.71602 of the *Michigan Compiled Laws*.

## MICHIGAN NONGAME FISH AND WILDLIFE TRUST FUND (formerly known as the Michigan Nongame Fish and Wildlife Fund)

The former Michigan Nongame Fish and Wildlife Fund was established in 1983 to finance research and management of nongame fish and wildlife, designated endangered species, and designated plant species of this State. Article IX, Section 42 of the State Constitution, an amendment approved by voters in November 2006, further protected these assets by creating the Michigan Nongame Fish and Wildlife Trust Fund.

The Fund operates under Sections 324.43902 - 324.43907 of the *Michigan Compiled Laws*. The Fund may receive transfers from other funds, donations, investment income, and revenue from specialty license plate sales.

## MICHIGAN CIVILIAN CONSERVATION CORPS ENDOWMENT FUND

Section 409.312a of the *Michigan Compiled Laws* established this Fund for the purpose of conserving, improving, and developing the State's natural resources and for enhancing, preserving, and maintaining public lands and waters through the employment of residents of this State in work training programs.

Twenty million dollars earmarked from the sale of the Accident Fund of Michigan provided the Fund's permanent investment reserve prior to fiscal year 2006-07. Only the interest and earnings of the Fund can be expended. Act 147, P.A. 2007, required

the transfer of \$20 million from the Fund to the General Fund, thereby eliminating the Fund's permanent investment reserve.

Prior to fiscal year 2006-07, this Fund was classified as a permanent fund, but the 2007 legislation resulted in the reclassification of this Fund as a special revenue fund.

#### FOREST DEVELOPMENT FUND

This Fund was established in 1993, along with the Michigan Forest Finance Authority, and operates under Section 324.50507 of the *Michigan Compiled Laws*. The primary revenue source of the Fund is timber revenue from State forest lands. Expenditures from the Fund are for forest management activities and forest fire protection. The Authority is authorized to, but thus far has not, issued bonds.

DEPARTMENT OF NATURAL RESOURCES

Combining Balance Sheet

Special Revenue Funds

As of September 30, 2007

(In Thousands)

	<u>Michigan Conservation and Recreation Legacy Fund</u>	<u>Michigan Game and Fish Protection Trust Fund</u>	<u>Combined Recreation Bond Fund - Local Projects</u>	<u>Michigan Nongame Fish and Wildlife Trust Fund</u>	<u>Michigan Civilian Conservation Corps Endowment Fund</u>
<b>ASSETS</b>					
Cash	\$ 231	\$	\$	\$	\$
Equity in common cash	97,045	66,862	2,162	1,198	961
Taxes, interest, and penalties receivable	191				
Securities lending collateral	256	42,530		2,660	11,088
Amounts due from other funds	754				
Amounts due from federal agencies	605				
Inventories	284				
Other current assets	4,732	1,731		59	197
Investments - Long-term	1,760	49,597		5,263	19,255
	<u>\$ 105,857</u>	<u>\$ 160,720</u>	<u>\$ 2,162</u>	<u>\$ 9,180</u>	<u>\$ 31,501</u>
<b>LIABILITIES AND FUND BALANCES</b>					
Liabilities:					
Warrants outstanding	\$ 1,121	\$ 2		\$ 1	\$ 2
Accounts payable and other liabilities	11,650	1,056	37	30	64
Obligations under security lending	256	42,530		2,660	11,088
Amounts due to other funds	589			2	20,001
Deferred revenue	667				
Total liabilities	<u>\$ 14,284</u>	<u>\$ 43,587</u>	<u>\$ 37</u>	<u>\$ 2,693</u>	<u>\$ 31,155</u>
Fund balances:					
Reserves for:					
Budgetary carry-forwards:					
Encumbrances	\$ 11,513	\$	\$	\$ 13	\$
Restricted revenues	30,597				
Multi-year projects	29,924				
Funds held as permanent investments	1,672	111,132		6,100	
Total reserved	<u>\$ 73,706</u>	<u>\$ 111,132</u>	<u>\$ 0</u>	<u>\$ 6,113</u>	<u>\$ 0</u>
Unreserved	17,868	6,000	2,125	374	346
Total fund balances	<u>\$ 91,574</u>	<u>\$ 117,132</u>	<u>\$ 2,125</u>	<u>\$ 6,487</u>	<u>\$ 346</u>
Total liabilities and fund balances	<u>\$ 105,857</u>	<u>\$ 160,720</u>	<u>\$ 2,162</u>	<u>\$ 9,180</u>	<u>\$ 31,501</u>

Forest Development Fund	Totals
\$ 1	\$ 232
8,662	176,889
	191
	56,534
	754
96	701
	284
184	6,904
	75,875
<u>\$ 8,942</u>	<u>\$ 318,363</u>

\$ 39	\$ 1,166
2,523	15,359
	56,534
124	20,716
	667
<u>\$ 2,685</u>	<u>\$ 94,441</u>

\$ 176	\$ 11,703
	30,597
1,503	31,427
	118,904
<u>\$ 1,679</u>	<u>\$ 192,630</u>
4,578	31,291
<u>\$ 6,257</u>	<u>\$ 223,921</u>
<u>\$ 8,942</u>	<u>\$ 318,363</u>

DEPARTMENT OF NATURAL RESOURCES  
Combining Balance Sheet  
Special Revenue Funds  
As of September 30, 2006  
(In Thousands)

	Game and Fish Protection Fund	Michigan State Waterways Fund	Marine Safety Fund	Game and Fish Protection Trust Fund	State Park Improvement Fund
<b>ASSETS</b>					
Cash	\$ 4	\$	\$	\$ 4	\$ 89
Equity in common cash	23,254	40,938	2,573	8,297	8,900
Taxes, interest, and penalties receivable		232			
Securities lending collateral	250			30,777	
Amounts due from federal agencies	385	231	89		
Inventories		228			
Other current assets	4,391	13	3	1,659	80
Investments - Long-term	1,732			100,101	
<b>Total assets</b>	<b>\$ 30,016</b>	<b>\$ 41,642</b>	<b>\$ 2,665</b>	<b>\$ 140,839</b>	<b>\$ 9,068</b>
<b>LIABILITIES AND FUND BALANCES</b>					
Liabilities:					
Warrants outstanding	\$ 150	\$ 76	\$ 38	\$	\$ 88
Accounts payable and other liabilities	3,453	1,842	1,883	976	1,835
Obligations under security lending	250			30,777	
Amounts due to other funds	514	98	8		314
Deferred revenue					529
<b>Total liabilities</b>	<b>\$ 4,367</b>	<b>\$ 2,016</b>	<b>\$ 1,928</b>	<b>\$ 31,754</b>	<b>\$ 2,766</b>
Fund balances:					
Reserves for:					
Budgetary carry-forwards:					
Encumbrances	\$ 1,842	\$ 11,512	\$ 115	\$	\$ 924
Restricted revenues	12,972				
Multi-year projects	676	25,180			1,717
Funds held as permanent investments	1,668			103,085	
<b>Total reserved</b>	<b>\$ 17,158</b>	<b>\$ 36,692</b>	<b>\$ 115</b>	<b>\$ 103,085</b>	<b>\$ 2,641</b>
Unreserved	8,491	2,935	622	6,000	3,661
<b>Total fund balances</b>	<b>\$ 25,649</b>	<b>\$ 39,626</b>	<b>\$ 737</b>	<b>\$ 109,085</b>	<b>\$ 6,302</b>
<b>Total liabilities and fund balances</b>	<b>\$ 30,016</b>	<b>\$ 41,642</b>	<b>\$ 2,665</b>	<b>\$ 140,839</b>	<b>\$ 9,068</b>

Combined Recreation Bond Fund - Local Projects	Michigan Nongame Fish and Wildlife Fund	Forest Development Fund	Totals
\$ 2,165	\$ 422	\$ 92	\$ 190
		12,922	99,472
	2,164		232
		256	33,191
			960
			228
	59	150	6,355
	5,879		107,711
<u>\$ 2,165</u>	<u>\$ 8,523</u>	<u>\$ 13,421</u>	<u>\$ 248,339</u>
	\$ 3	\$ 28	\$ 383
113	59	2,972	13,132
	2,164		33,191
	2	187	1,125
			529
<u>\$ 113</u>	<u>\$ 2,228</u>	<u>\$ 3,187</u>	<u>\$ 48,360</u>
\$	\$ 19	\$ 1,597	\$ 16,008
			12,972
		1,904	29,478
	5,956		110,709
<u>\$ 0</u>	<u>\$ 5,976</u>	<u>\$ 3,501</u>	<u>\$ 169,167</u>
2,052	319	6,732	30,812
<u>\$ 2,052</u>	<u>\$ 6,295</u>	<u>\$ 10,233</u>	<u>\$ 199,979</u>
<u>\$ 2,165</u>	<u>\$ 8,523</u>	<u>\$ 13,421</u>	<u>\$ 248,339</u>



Michigan Game and Fish Protection Trust Fund	State Park Improvement Fund	Combined Recreation Bond Fund - Local Projects	Michigan Nongame Fish and Wildlife Trust Fund	Michigan Civilian Conservation Corps Endowment Fund	Forest Development Fund	Totals
\$	\$	\$	\$	\$	\$	\$ 304
					96	4,788
					1	112,129
21,980		114	871	1,832	26,360	58,274
<u>\$ 21,980</u>	<u>\$ 0</u>	<u>\$ 114</u>	<u>\$ 871</u>	<u>\$ 1,832</u>	<u>\$ 26,458</u>	<u>\$ 175,495</u>
\$	\$	\$	\$	\$	\$	\$
74		41	548	795	28,735	172,510
2,007			127	518		2,668
					529	9,659
<u>\$ 2,082</u>	<u>\$ 0</u>	<u>\$ 41</u>	<u>\$ 675</u>	<u>\$ 1,313</u>	<u>\$ 29,264</u>	<u>\$ 184,837</u>
\$ 19,898	\$ 0	\$ 73	\$ 195	\$ 520	\$ (2,806)	\$ (9,342)
\$	\$	\$	\$	\$	\$	\$
(11,851)	(6,302)		(3)	(20,003)	(1,170)	121,394
<u>\$ (11,851)</u>	<u>\$ (6,302)</u>	<u>\$ 0</u>	<u>\$ (3)</u>	<u>\$ (20,003)</u>	<u>\$ (1,170)</u>	<u>\$ (107,939)</u>
\$	\$	\$	\$	\$	\$	\$
8,047	(6,302)	73	192	(19,483)	(3,976)	4,113
109,085	6,302	2,052	6,295	19,829	10,233	219,809
<u>\$ 117,132</u>	<u>\$ 0</u>	<u>\$ 2,125</u>	<u>\$ 6,487</u>	<u>\$ 346</u>	<u>\$ 6,257</u>	<u>\$ 223,921</u>

DEPARTMENT OF NATURAL RESOURCES  
Combining Statement of Revenues, Expenditures, and Changes in Fund Balances  
Special Revenue Funds  
Fiscal Year Ended September 30, 2006  
(In Thousands)

	Game and Fish Protection Fund	Michigan State Waterways Fund	Marine Safety Fund	Game and Fish Protection Trust Fund	State Park Improvement Fund
<b>REVENUES</b>					
Taxes	\$	\$ 332	\$	\$	\$
From federal agencies	2,213	389	89		
From licenses and permits	49,897	6,811	4,762		39,606
Miscellaneous	3,277	2,583	228	15,553	308
Total revenues	<u>\$ 55,387</u>	<u>\$ 10,115</u>	<u>\$ 5,078</u>	<u>\$ 15,553</u>	<u>\$ 39,913</u>
<b>EXPENDITURES</b>					
Current	\$ 63,855	\$ 16,466	\$ 5,339	\$ 76	\$ 36,477
General government	5			333	
Capital outlay	3,156	5,141			1,175
Total expenditures	<u>\$ 67,017</u>	<u>\$ 21,608</u>	<u>\$ 5,339</u>	<u>\$ 409</u>	<u>\$ 37,652</u>
Excess of revenues over (under) expenditures	<u>\$ (11,631)</u>	<u>\$ (11,492)</u>	<u>\$ (261)</u>	<u>\$ 15,144</u>	<u>\$ 2,262</u>
<b>OTHER FINANCING SOURCES (USES)</b>					
Transfers from other funds	\$ 11,414	\$ 14,415	\$	\$	\$
Transfers to other funds	(380)	(164)	(13)	(11,414)	(1,336)
Total other financing sources (uses)	<u>\$ 11,034</u>	<u>\$ 14,251</u>	<u>\$ (13)</u>	<u>\$ (11,414)</u>	<u>\$ (1,336)</u>
Excess of revenues and other sources over (under) expenditures and other uses	\$ (596)	\$ 2,758	\$ (274)	\$ 3,730	\$ 925
Fund balances - Beginning of fiscal year	<u>26,245</u>	<u>36,868</u>	<u>1,011</u>	<u>105,355</u>	<u>5,377</u>
Fund balances - End of fiscal year	<u>\$ 25,649</u>	<u>\$ 39,626</u>	<u>\$ 737</u>	<u>\$ 109,085</u>	<u>\$ 6,302</u>

Combined Recreation Bond Fund - Local Projects	Michigan Nongame Fish and Wildlife Fund	Forest Development Fund	Totals
\$	\$	\$	\$
	97	256	332
		1	3,043
			101,076
103	587	27,236	49,875
<u>\$ 103</u>	<u>\$ 683</u>	<u>\$ 27,493</u>	<u>\$ 154,326</u>
\$	\$	\$	\$
77	668	30,757	153,717
	18		356
		358	9,830
<u>\$ 77</u>	<u>\$ 686</u>	<u>\$ 31,115</u>	<u>\$ 163,904</u>
<u>\$ 26</u>	<u>\$ (3)</u>	<u>\$ (3,622)</u>	<u>\$ (9,578)</u>
\$	\$	\$	\$
(2)	(3)	(1,158)	25,829
<u>\$ (2)</u>	<u>\$ (3)</u>	<u>\$ (1,158)</u>	<u>(14,470)</u>
\$	\$	\$	\$
24	(6)	(4,779)	1,782
2,028	6,301	15,013	198,197
<u>\$ 2,052</u>	<u>\$ 6,295</u>	<u>\$ 10,233</u>	<u>\$ 199,979</u>



## Descriptions of Permanent Funds

### MICHIGAN NATURAL RESOURCES TRUST FUND

The State Constitution was amended in 1984 to provide for the Michigan Natural Resources Trust Fund. The Fund, established in 1985, operates under Sections 324.1901 - 324.1910 of the *Michigan Compiled Laws*. Most royalty revenues (i.e., rentals and other revenues derived from mineral, coal, oil, and gas interests on State-owned lands) are credited to the Fund. Section 324.1902 of the *Michigan Compiled Laws* directs a portion (50%, up to \$10 million per year) of these revenues to the Michigan State Parks Endowment Fund. The voters approved a constitutional amendment in August 2002 that increased the amount which can be accumulated to \$500 million, modified the distribution formula, and allows the State Treasurer to invest in equity securities and other types of investments.

In accordance with statutory provisions, this Fund is to accumulate up to \$500 million in accumulated principal. The amount accumulated toward this cap is shown as a reservation of fund balance. Investment earnings and one-third of royalty revenues are available for appropriation. Two-thirds of royalty revenues, less the portion transferred to the Michigan State Parks Endowment Fund, are added to the accumulated principal until the accumulated principal reaches \$500 million. After that time, all royalties will be deposited into the Michigan State Parks Endowment Fund and only investment earnings and interest will be available for appropriation in the Michigan Natural Resources Trust Fund. Appropriations are used to fund grants to local units of government as well as State agencies to acquire land or develop public recreation facilities and to fund payments in lieu of property taxes on State lands acquired by the Fund.

### MICHIGAN STATE PARKS ENDOWMENT FUND

Established in 1994, this Fund is governed by the provisions of Section 324.74119 of the *Michigan Compiled Laws* to finance operations, maintenance, and capital improvements at Michigan State parks. The voters approved a constitutional amendment in August 2002 that changed the distribution formula and allows the State Treasurer to invest in equity securities and other types of investments.

The Fund was established with a \$40 million transfer from the sale of the Accident Fund of Michigan to provide funds for permanent investment. By statute, up to \$10 million per year of revenues from oil and gas bonuses, rentals, and royalties from State-owned

land are deposited into this Fund until the Michigan Natural Resources Trust Fund reaches an accumulated principal of \$500 million after which time all revenue previously going to the Michigan Natural Resources Trust Fund will go to this Fund. The Fund's investment reserve will be capped at \$800 million. The Legislature is limited to appropriating no more than 50% of the amount transferred from the Michigan Natural Resources Trust Fund plus interest and investment earnings. When the Fund's reserve reaches \$800 million, only the interest and earnings in excess of the amount needed to maintain the \$800 million principal limit, adjusted annually for inflation, may be expended.

#### MICHIGAN CIVILIAN CONSERVATION CORPS ENDOWMENT FUND

Section 409.312a of the *Michigan Compiled Laws* established this Fund for the purpose of conserving, improving, and developing the State's natural resources and for enhancing, preserving, and maintaining public lands and waters through the employment of residents of this State in work training programs.

Twenty million dollars earmarked from the sale of the Accident Fund of Michigan provided the Fund's permanent investment reserve. Only the interest and earnings of the Fund can be expended. Act 147, P.A. 2007, required the transfer of \$20 million from the Fund to the General Fund, thereby eliminating the Fund's permanent investment reserve.

In fiscal year 2005-06 and prior years, this was classified as a permanent fund, but the 2007 legislation resulted in the reclassification of this Fund as a special revenue fund.

DEPARTMENT OF NATURAL RESOURCES  
Combining Balance Sheet  
Permanent Funds  
As of September 30, 2007  
(In Thousands)

	Michigan Natural Resources Trust Fund	Michigan State Parks Endowment Fund	Totals
<b>ASSETS</b>			
Equity in common cash	\$ 234,532	\$ 54,982	\$ 289,514
Securities lending collateral	114,890	59,460	174,350
Other current assets	11,418	1,180	12,598
Investments - Long-term	213,888	90,061	303,949
	<u>574,727</u>	<u>205,682</u>	<u>780,409</u>
<b>Total assets</b>	<b>\$ 574,727</b>	<b>\$ 205,682</b>	<b>\$ 780,409</b>
<b>LIABILITIES AND FUND BALANCES</b>			
<b>Liabilities:</b>			
Warrants outstanding	\$ 348	\$ 76	\$ 424
Accounts payable and other liabilities	15,606	895	16,500
Obligations under security lending	114,890	59,460	174,350
Amounts due to other funds	12	40	52
<b>Total liabilities</b>	<b>\$ 130,856</b>	<b>\$ 60,470</b>	<b>\$ 191,326</b>
<b>Fund balances:</b>			
<b>Reserves for:</b>			
<b>Budgetary carry-forwards:</b>			
Encumbrances	\$ 15,231	\$ 85	\$ 15,316
Restricted revenues		3,093	3,093
Multi-year projects	51,299	101	51,400
Funds held as permanent investments	345,314	132,100	477,414
<b>Total reserved</b>	<b>\$ 411,844</b>	<b>\$ 135,379</b>	<b>\$ 547,223</b>
Unreserved	32,028	9,833	41,860
<b>Total fund balances</b>	<b>\$ 443,872</b>	<b>\$ 145,212</b>	<b>\$ 589,084</b>
	<u>574,727</u>	<u>205,682</u>	<u>780,409</u>
<b>Total liabilities and fund balances</b>	<b>\$ 574,727</b>	<b>\$ 205,682</b>	<b>\$ 780,409</b>

DEPARTMENT OF NATURAL RESOURCES  
Combining Balance Sheet  
Permanent Funds  
As of September 30, 2006  
(In Thousands)

	Michigan Natural Resources Trust Fund	Michigan State Parks Endowment Fund	Michigan Civilian Conservation Corps Endowment Fund	Totals
<b>ASSETS</b>				
Equity in common cash	\$ 122,189	\$ 14,830	\$ 753	\$ 137,772
Securities lending collateral	84,078	45,265	7,953	137,295
Other current assets	11,326	1,160	195	12,680
Investments - Long-term	285,686	118,794	18,954	423,434
<b>Total assets</b>	<b>\$ 503,278</b>	<b>\$ 180,049</b>	<b>\$ 27,854</b>	<b>\$ 711,181</b>
<b>LIABILITIES AND FUND BALANCES</b>				
Liabilities:				
Warrants outstanding	\$ 235	\$ 121	\$ 1	\$ 357
Accounts payable and other liabilities	15,397	1,156	68	16,621
Obligations under security lending	84,078	45,265	7,953	137,295
Amounts due to other funds	19	46	3	69
Deferred revenue	1,330			1,330
<b>Total liabilities</b>	<b>\$ 101,059</b>	<b>\$ 46,588</b>	<b>\$ 8,025</b>	<b>\$ 155,672</b>
Fund balances:				
Reserves for:				
Budgetary carry-forwards:				
Encumbrances	\$ 10,641	\$ 186	\$	\$ 10,826
Multi-year projects	44,265	78		44,343
Funds held as permanent investments	312,509	122,895	19,355	454,758
<b>Total reserved</b>	<b>\$ 367,415</b>	<b>\$ 123,158</b>	<b>\$ 19,355</b>	<b>\$ 509,927</b>
Unreserved	34,805	10,302	475	45,582
<b>Total fund balances</b>	<b>\$ 402,220</b>	<b>\$ 133,461</b>	<b>\$ 19,829</b>	<b>\$ 555,509</b>
<b>Total liabilities and fund balances</b>	<b>\$ 503,278</b>	<b>\$ 180,049</b>	<b>\$ 27,854</b>	<b>\$ 711,181</b>

DEPARTMENT OF NATURAL RESOURCES  
Combining Statement of Revenues, Expenditures, and Changes in Fund Balances  
Permanent Funds  
Fiscal Year Ended September 30, 2007  
(In Thousands)

	Michigan Natural Resources Trust Fund	Michigan State Parks Endowment Fund	Totals
<b>REVENUES AND OTHER SOURCES</b>			
Miscellaneous	\$ 79,758	\$ 17,687	\$ 97,445
Total revenues	<u>\$ 79,758</u>	<u>\$ 17,687</u>	<u>\$ 97,445</u>
<b>EXPENDITURES</b>			
Current	\$ 2,525	\$ 12,833	\$ 15,359
General government	5,521	3,007	8,528
Capital outlay	20,075	34	20,109
Total expenditures	<u>\$ 28,122</u>	<u>\$ 15,873</u>	<u>\$ 43,995</u>
Excess of revenues over (under) expenditures	<u>\$ 51,636</u>	<u>\$ 1,813</u>	<u>\$ 53,450</u>
<b>OTHER FINANCING SOURCES (USES)</b>			
Proceeds from sale of capital assets	\$ 29	\$	\$ 29
Transfers from other funds		10,000	10,000
Transfers to other funds	(10,014)	(62)	(10,076)
Total other financing sources (uses)	<u>\$ (9,985)</u>	<u>\$ 9,938</u>	<u>\$ (46)</u>
Excess of revenues and other sources over (under) expenditures and other uses	\$ 41,652	\$ 11,752	\$ 53,403
Fund balances - Beginning of fiscal year - Restated	<u>402,220</u>	<u>133,461</u>	<u>535,680</u>
Fund balances - End of fiscal year	<u><u>\$ 443,872</u></u>	<u><u>\$ 145,212</u></u>	<u><u>\$ 589,084</u></u>

**DEPARTMENT OF NATURAL RESOURCES**  
Combining Statement of Revenues, Expenditures, and Changes in Fund Balances  
Permanent Funds  
Fiscal Year Ended September 30, 2006  
(In Thousands)

	Michigan Natural Resources Trust Fund	Michigan State Parks Endowment Fund	Michigan Civilian Conservation Corps Endowment Fund	Totals
<b>REVENUES AND OTHER SOURCES</b>				
Miscellaneous	\$ 71,838	\$ 7,834	\$ 868	\$ 80,540
Total revenues	<u>\$ 71,838</u>	<u>\$ 7,834</u>	<u>\$ 868</u>	<u>\$ 80,540</u>
<b>EXPENDITURES</b>				
Current	\$ 2,782	\$ 12,294	\$ 858	\$ 15,933
General government	898	464	115	1,477
Capital outlay	33,550	1,667		35,217
Total expenditures	<u>\$ 37,229</u>	<u>\$ 14,426</u>	<u>\$ 972</u>	<u>\$ 52,627</u>
Excess of revenues over (under) expenditures	<u>\$ 34,608</u>	<u>\$ (6,591)</u>	<u>\$ (104)</u>	<u>\$ 27,914</u>
<b>OTHER FINANCING SOURCES (USES)</b>				
Proceeds from sale of capital assets	\$ 123	\$	\$	\$ 123
Transfers from other funds		10,000		10,000
Transfers to other funds	(10,011)	(66)	(3)	(10,079)
Total other financing sources (uses)	<u>\$ (9,888)</u>	<u>\$ 9,934</u>	<u>\$ (3)</u>	<u>\$ 44</u>
Excess of revenues and other sources over (under) expenditures and other uses	<u>\$ 24,721</u>	<u>\$ 3,343</u>	<u>\$ (106)</u>	<u>\$ 27,957</u>
Fund balances - Beginning of fiscal year	<u>377,499</u>	<u>130,118</u>	<u>19,936</u>	<u>527,552</u>
Fund balances - End of fiscal year	<u><u>\$ 402,220</u></u>	<u><u>\$ 133,461</u></u>	<u><u>\$ 19,829</u></u>	<u><u>\$ 555,509</u></u>

## Description of Capital Projects Fund

### COMBINED RECREATION BOND FUND - STATE PROJECTS

Established in 1988, this Fund operates under Sections 324.19601 - 324.19616, 324.71501 - 324.71514, and 324.74106 - 324.74113 of the *Michigan Compiled Laws*. The balances in the Fund reflect proceeds and investment earnings remaining from two bond packages: \$70 million of general obligation bonds approved by voters in November 1988, as part of a \$140 million bond package for financing State and local public recreation projects, and \$50 million of general obligation bonds approved by voters in November 1998, as part of a \$675 million bond package known as the "Clean Michigan Initiative."

Proceeds from the 1988 bond package were used to construct, expand, and develop recreational facilities at State parks. Proceeds from the 1998 bond package were used for infrastructure improvements at State parks with the installation or upgrade of drinking water systems or restroom facilities as a first priority.

The capital projects fund's financial statements are presented as a part of the governmental fund types, combined financial statements on pages 14 through 17.

DEPARTMENT OF NATURAL RESOURCES  
Schedule of Expenditures of Federal Awards (1)  
For the Period October 1, 2005 through September 30, 2007

Federal Agency/Program or Cluster	CFDA (2) Number	For the Fiscal Year Ended September 30, 2006		
		Directly Expended	Distributed to Subrecipients	Total Expended and Distributed
<b><u>U.S. Department of Agriculture</u></b>				
Direct Programs:				
Plant and Animal Disease, Pest Control, and Animal Care	10.025	\$ 109,243	\$	\$ 109,243
Conservation Reserve Program	10.069	46,136		46,136
Cooperative Forestry Assistance	10.664	1,675,986	1,471,989	3,147,975
Schools and Roads - Grants to States	10.665		2,909,728	2,909,728
Forest Legacy Program	10.676	502,212		502,212
Forest Land Enhancement Program	10.677	33,569		33,569
<b>Total U.S. Department of Agriculture</b>		<b>\$ 2,367,146</b>	<b>\$ 4,381,717</b>	<b>\$ 6,748,863</b>
<b><u>U.S. Department of Commerce</u></b>				
Direct Programs:				
Anadromous Fish Conservation Act Program	11.405	\$ 25,233	\$	\$ 25,233
Interjurisdictional Fisheries Act of 1986	11.407	7,877		7,877
<b>Total U.S. Department of Commerce</b>		<b>\$ 33,110</b>	<b>\$ 0</b>	<b>\$ 33,110</b>
<b><u>U.S. Department of the Interior</u></b>				
Fish and Wildlife Cluster:				
Direct Programs:				
Sport Fish Restoration Program	15.605	\$ 9,359,907	\$	\$ 9,359,907
Wildlife Restoration	15.611	9,001,193		9,001,193
Total Fish and Wildlife Cluster		<u>\$ 18,361,100</u>	<u>\$ 0</u>	<u>\$ 18,361,100</u>
Direct Programs:				
Fish and Wildlife Management Assistance	15.608	\$	\$	\$ 0
Coastal Wetlands Planning, Protection, and Restoration Act	15.614			0
Cooperative Endangered Species Conservation Fund	15.615	859,329		859,329
Clean Vessel Act	15.616	8,842	67,778	76,620
Wildlife Conservation and Restoration	15.625	28,497		28,497
Landowner Incentive Program	15.633	636,351		636,351
State Wildlife Grants	15.634	3,300,120		3,300,120
Outdoor Recreation - Acquisition, Development and Planning	15.916	2,085,231	2,211,962	4,297,193
Endangered Species	15.UNKNOWN (3)			0
Total Direct Programs		<u>\$ 6,918,370</u>	<u>\$ 2,279,740</u>	<u>\$ 9,198,110</u>
<b>Total U.S. Department of the Interior</b>		<b>\$ 25,279,470</b>	<b>\$ 2,279,740</b>	<b>\$ 27,559,210</b>
<b><u>U.S. Department of Transportation</u></b>				
Direct Program:				
Recreational Trails Program	20.219	\$ 844,391	\$	\$ 844,391
<b>Total U.S. Department of Transportation</b>		<b>\$ 844,391</b>	<b>\$ 0</b>	<b>\$ 844,391</b>
<b><u>U.S. Environmental Protection Agency</u></b>				
Direct Program:				
Great Lakes Program	66.469	\$	\$	\$ 0
<b>Total U.S. Environmental Protection Agency</b>		<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ 0</b>

This schedule continued on next page.

For the Fiscal Year Ended September 30, 2007			Total Expended and Distributed for the Two-Year Period
Directly Expended	Distributed to Subrecipients	Total Expended and Distributed	
\$ 155,636	\$	\$ 155,636	\$ 264,879
18,881		18,881	65,017
2,082,509	1,493,167	3,575,676	6,723,651
	2,769,742	2,769,742	5,679,470
18,811		18,811	521,023
199,078		199,078	232,647
<b>\$ 2,474,915</b>	<b>\$ 4,262,909</b>	<b>\$ 6,737,824</b>	<b>\$ 13,486,687</b>
\$ 30,661	\$	\$ 30,661	\$ 55,894
11,900		11,900	19,777
<b>\$ 42,561</b>	<b>\$ 0</b>	<b>\$ 42,561</b>	<b>\$ 75,671</b>
\$ 11,056,500	\$	\$ 11,056,500	\$ 20,416,407
7,613,160		7,613,160	16,614,353
<b>\$ 18,669,660</b>	<b>\$ 0</b>	<b>\$ 18,669,660</b>	<b>\$ 37,030,760</b>
\$ 10,114	\$	\$ 10,114	\$ 10,114
334,605		334,605	334,605
846,004		846,004	1,705,333
12,955	101,236	114,191	190,811
		0	28,497
656,027		656,027	1,292,378
2,266,094		2,266,094	5,566,214
952,839	1,051,793	2,004,632	6,301,825
8		8	8
<b>\$ 5,078,646</b>	<b>\$ 1,153,029</b>	<b>\$ 6,231,675</b>	<b>\$ 15,429,785</b>
<b>\$ 23,748,306</b>	<b>\$ 1,153,029</b>	<b>\$ 24,901,335</b>	<b>\$ 52,460,545</b>
\$ 1,139,690	\$	\$ 1,139,690	\$ 1,984,081
<b>\$ 1,139,690</b>	<b>\$ 0</b>	<b>\$ 1,139,690</b>	<b>\$ 1,984,081</b>
\$ 2,480	\$	\$ 2,480	\$ 2,480
<b>\$ 2,480</b>	<b>\$ 0</b>	<b>\$ 2,480</b>	<b>\$ 2,480</b>

DEPARTMENT OF NATURAL RESOURCES  
Schedule of Expenditures of Federal Awards (1)  
For the Period October 1, 2005 through September 30, 2007  
Continued

Federal Agency/Program or Cluster	CFDA (2) Number	For the Fiscal Year Ended September 30, 2006		
		Directly Expended	Distributed to Subrecipients	Total Expended and Distributed
<b><u>U.S. Department of Homeland Security</u></b>				
Direct Programs:				
Boating Safety Financial Assistance	97.012	\$ 3,900,415	\$ 1,363,021	\$ 5,263,436
Assistance to Firefighters Grant	97.044			0
<b>Total U.S. Department of Homeland Security</b>		<b>\$ 3,900,415</b>	<b>\$ 1,363,021</b>	<b>\$ 5,263,436</b>
Total Expenditures of Federal Awards		<b>\$ 32,424,532</b>	<b>\$ 8,024,478</b>	<b>\$ 40,449,010</b>

(1) Basis of Presentation: This schedule presents the federal grant activity of the Department of Natural Resources on the modified accrual basis of accounting and in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the financial statements and financial schedules.

(2) CFDA is defined as *Catalog of Federal Domestic Assistance*.

(3) CFDA number is not available.

<u>For the Fiscal Year Ended September 30, 2007</u>			<u>Total Expended and Distributed for the Two-Year Period</u>
<u>Directly Expended</u>	<u>Distributed to Subrecipients</u>	<u>Total Expended and Distributed</u>	
\$ 6,877,681	\$ 1,302,142	\$ 8,179,823	\$ 13,443,259
238,250		238,250	\$ 238,250
<b>\$ 7,115,931</b>	<b>\$ 1,302,142</b>	<b>\$ 8,418,073</b>	<b>\$ 13,681,509</b>
<b>\$34,523,883</b>	<b>\$ 6,718,080</b>	<b>\$ 41,241,963</b>	<b>\$ 81,690,973</b>



INDEPENDENT AUDITOR'S REPORTS ON  
INTERNAL CONTROL AND COMPLIANCE



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

Independent Auditor's Report on Internal Control Over  
Financial Reporting and on Compliance and Other Matters

Mr. Keith J. Charters, Chair  
Natural Resources Commission  
and  
Ms. Rebecca A. Humphries, Director  
Department of Natural Resources  
Stevens T. Mason Building  
Lansing, Michigan

Dear Mr. Charters and Ms. Humphries:

We have audited the financial statements and financial schedules of the Department of Natural Resources as of and for the fiscal years ended September 30, 2007 and September 30, 2006, as identified in the table of contents, and have issued our reports thereon dated December 30, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements and financial schedules, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed in the next paragraph, we identified a deficiency in internal control over financial reporting that we consider to be a significant deficiency.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements and/or financial schedules that is more than

inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiency described in Finding 1 in the accompanying schedule of findings and questioned costs to be a significant deficiency in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements and/or financial schedules will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that the significant deficiency described in the third paragraph of this section is not a material weakness.

#### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department's financial statements and financial schedules are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement and/or financial schedule amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The Department's responses to the findings identified in our audit are described in the accompanying corrective action plan. We did not audit the Department's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of management, the Natural Resources Commission, others within the Department, the Legislature, and federal awarding agencies and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

AUDITOR GENERAL

December 30, 2008



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

Independent Auditor's Report on Compliance With  
Requirements Applicable to Each Major Program  
and on Internal Control Over Compliance in  
Accordance With OMB Circular A-133

Mr. Keith J. Charters, Chair  
Natural Resources Commission  
and  
Ms. Rebecca A. Humphries, Director  
Department of Natural Resources  
Stevens T. Mason Building  
Lansing, Michigan

Dear Mr. Charters and Ms. Humphries:

Compliance

We have audited the compliance of the Department of Natural Resources with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each major federal program for the two-year period ended September 30, 2007. The Department's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each major federal program is the responsibility of the Department's management. Our responsibility is to express an opinion on the Department's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to in the preceding paragraph that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Department's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Department's compliance with those requirements.

As described in Findings 5 and 7 in the accompanying schedule of findings and questioned costs, the Department did not comply with requirements regarding activities allowed or unallowed; allowable costs/cost principles; matching, level of effort, and earmarking; and period of availability that are applicable to its State Wildlife Grants and Boating Safety Financial Assistance programs. Compliance with such requirements is necessary, in our opinion, for the Department to comply with the requirements applicable to those programs.

In our opinion, except for the noncompliance described in the preceding paragraph, the Department of Natural Resources complied, in all material respects, with the requirements referred to in the first

paragraph that are applicable to each of its major federal programs for the two-year period ended September 30, 2007. The results of our auditing procedures also disclosed other instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as Findings 2 through 7.

#### Internal Control Over Compliance

The management of the Department is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Department's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the Department's internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies and others that we consider to be material weaknesses.

A control deficiency in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as Findings 2 through 7 to be significant deficiencies.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. Of the significant deficiencies described in the preceding paragraph, we consider Findings 5 and 7 to be material weaknesses.

The Department's responses to the findings identified in our audit are described in the accompanying corrective action plan. We did not audit the Department's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of management, the Natural Resources Commission, others within the Department, the Legislature, and federal awarding agencies and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

AUDITOR GENERAL

December 30, 2008

# SCHEDULE OF FINDINGS AND QUESTIONED COSTS

## Section I: Summary of Auditor's Results

### Financial Statements and Financial Schedules

Type of auditor's reports issued: Unqualified\*

Internal control\* over financial reporting:

Material weaknesses\* identified? No

Significant deficiencies\* identified that are not considered to be material weaknesses? Yes

Noncompliance or other matters material to the financial statements and/or financial schedules? No

### Federal Awards

Internal control over major programs:

Material weaknesses\* identified? Yes

Significant deficiencies\* identified that are not considered to be material weaknesses? Yes

Type of auditor's report issued on compliance for major programs:

Unqualified for all major programs except for State Wildlife Grants and Boating Safety Financial Assistance, which are qualified\*.

Any audit findings disclosed that are required to be reported in accordance with U.S. Office of Management and Budget (OMB) Circular A-133, Section 510(a)? Yes

Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>
10.664	Cooperative Forestry Assistance
10.665	Schools and Roads - Grants to States
15.605 and 15.611	Fish and Wildlife Cluster
15.634	State Wildlife Grants
15.916	Outdoor Recreation - Acquisition, Development and Planning
97.012	Boating Safety Financial Assistance

\* See glossary at end of report for definition.

Dollar threshold used to distinguish between type A and type B programs: \$2,450,729

Auditee qualified as a low-risk auditee\*? No

## **Section II: Findings Related to the Financial Statements and Financial Schedules**

### **FINDING (7510801)**

#### **1. Internal Control Over Accounts Payable**

The Department of Natural Resources' (DNR's) internal control over recording accounts payable for the General Fund and the Michigan Natural Resources Trust Fund (MNRTF) did not ensure that accounts payable were recorded at the proper amount and that expenditures were recorded in the proper fiscal year and at the proper amount. As a result, accounts payable and expenditures were misstated in both the General Fund and the MNRTF.

Sections 1600.116 - 1600.119 of the *Codification of Governmental Accounting and Financial Reporting Standards*, published by the Governmental Accounting Standards Board (GASB), require that a government accrue governmental fund liabilities and expenditures in the period in which the government incurs the liability. Part II, Chapter 14, Section 100 of the State of Michigan Financial Management Guide provides that accounts payable may be recorded on an actual or, if necessary, estimated basis. In addition, Part II, Chapter 1, Section 300 of the Financial Management Guide provides that accounts payable should be recorded by the provider when a grant recipient provides a service or incurs reimbursable costs related to a specific program.

DNR did not have a process in place to require further evaluation of accounts payable when estimates appear to be overstated. Our review of 50 General Fund expenditure transactions and 23 MNRTF expenditure transactions disclosed:

- a. DNR overestimated one fiscal year 2006-07 General Fund account payable transaction by \$1,501,390. DNR established the account payable for \$2,141,808 for aircraft related expenditures based on an estimation of costs

\* See glossary at end of report for definition.

incurred to fight the Sleeper Lake fire. However, prior to the State's deadline for recording accounts payable, DNR received a billing from the vendor that indicated a total billing of \$640,417. DNR informed us that it did not adjust the estimated account payable because it believed the billing might not be final due to the significant difference between the estimate and the billing received. However, DNR did not follow up with the vendor to determine the reason for the difference before the State's deadline for recording accounts payable. As a result, DNR overstated its accounts payable and expenditures by \$1,501,390.

In addition, in our sample of expenditure transactions, we identified two fiscal year 2006-07 General Fund misstatements of accounts payable and expenditures. These misstatements resulted in a net overstatement of accounts payable and expenditures of \$108,778 and a known and likely net overstatement of \$151,556.

- b. DNR recorded an MNRTF account payable for a liability that had not been incurred by year-end. DNR received documentation from a grantee that estimated it would incur reimbursable costs of \$1,819,717 and that the costs would be incurred before the end of fiscal year 2005-06. DNR recorded an account payable and an expenditure for the estimated reimbursable costs of \$1,819,717. However, prior to the State's deadline for recording accounts payable, DNR learned that the actual reimbursable costs were not incurred by the grantee by the end of fiscal year 2005-06. DNR did not eliminate the recorded account payable. As a result, fiscal year 2005-06 accounts payable and expenditures were overstated and fiscal year 2006-07 expenditures were understated by \$1,819,717, respectively.

In response to a similar finding in the prior audit report, DNR indicated that it agreed with our recommendation to improve its internal control over accounts payable and stated that it would comply.

## **RECOMMENDATIONS**

We recommend that DNR improve its internal control over recording General Fund accounts payable to ensure that accounts payable and expenditures are recorded at the proper amount.

WE AGAIN RECOMMEND THAT DNR IMPROVE ITS INTERNAL CONTROL OVER RECORDING ACCOUNTS PAYABLE FOR MNRTF EXPENDITURES TO ENSURE THAT EXPENDITURES ARE RECORDED IN THE PROPER FISCAL YEAR.

The status of the findings related to the financial statements and financial schedules that were reported in prior Single Audits\* is disclosed in the summary schedule of prior audit findings.

### Section III: Findings and Questioned Costs\* Related to Federal Awards

#### **FINDING (7510802)**

2. Cooperative Forestry Assistance, CFDA 10.664

U.S. Department of Agriculture	CFDA 10.664: Cooperative Forestry Assistance
Award Number: 03-DG-11244225-268 04-DG-11244225-045 05-DG-11244225-037 05-DG-11244225-344 06-DG-11244225-010 06-DG-11244225-074	Award Period: 10/01/2002 - 09/30/2006 10/01/2003 - 09/30/2008 10/01/2004 - 09/30/2007 10/01/2004 - 09/30/2007 10/01/2005 - 09/30/2008 10/01/2005 - 09/30/2008
	Questioned Costs: \$2,731

DNR's internal control over the Cooperative Forestry Assistance Program did not ensure compliance with federal laws and regulations regarding allowable costs/cost principles, reporting, and subrecipient\* monitoring. Our review also disclosed significant deficiencies in internal control related to procurement and suspension and debarment.

Internal control that does not ensure compliance with federal laws and regulations could result in sanctions and/or disallowances for the Cooperative Forestry Assistance Program.

Federal expenditures for the Cooperative Forestry Assistance Program totaled \$6,723,651 for the two-year period ended September 30, 2007. We identified

\* See glossary at end of report for definition.

known questioned costs of \$2,731 and known and likely questioned costs totaling \$12,365.

Our review of expenditures and program files disclosed:

a. Allowable Costs/Cost Principles

- (1) DNR's internal control did not ensure that Cooperative Forestry Assistance Program expenditures met allowable cost principles of Title 2, Part 225, Appendix A of the of the *Code of Federal Regulations (CFR)*.

For 1 (1%) of 68 expenditures sampled, DNR documentation did not support the payment amount. As a result, we identified known questioned costs of \$1,430 and known and likely questioned costs of \$11,064.

Appendix A, Section C of federal regulation 2 *CFR* 225 requires that DNR adequately support costs charged to federal awards.

- (2) DNR did not ensure that time and activity records were certified by the employee.

Our review of 20 payroll transactions sampled disclosed 2 (10%) transactions for two employees who did not enter their own time into the State's payroll time and attendance system (the Data Collection and Distribution System\* [DCDS]) or complete and maintain hard copy time and activity records. DNR informed us that the staff working in field locations often did not have access to DCDS. However, DNR did not have a compensating control to ensure that the employees certified (via manual signature or electronic entry) their hours and activities that were entered on their behalf by another employee. As a result, DNR could not ensure that the employees certified their hours and activities charged to the Cooperative Forestry Assistance Program. We identified known questioned costs totaling \$1,301 related to these payroll transactions.

\* See glossary at end of report for definition.

Appendix B, section 8 of federal regulation 2 *CFR* 225 requires employees who are charged to multiple activities or cost objectives to document and maintain personnel activity reports or equivalent documentation that supports the distribution of their payroll costs. Personnel activity reports or equivalent documentation must be signed by the employee. In addition, DNR policy 15.01-02, Payroll Costs Charged to Federal Aid Grants, requires employees to prepare time sheets or to record their time in DCDS.

b. Procurement and Suspension and Debarment

DNR did not have a process to ensure that vendors and subrecipients were not on the federal Excluded Parties List System.

Our review disclosed that 11 (35%) of 31 contracts, applications, or grant agreements sampled did not include language that informed the vendors or subrecipients that, by signing the contract, application, or grant agreement, they were certifying that they have not been suspended or debarred. In addition, DNR did not have other controls in place to verify that vendors and subrecipients were not on the federal Excluded Parties List System.

We reviewed the federal Excluded Parties List System and verified that none of the vendors or subrecipients in our sample of Cooperative Forestry Assistance Program expenditures were suspended or debarred during the respective fiscal years. As a result, we have not reported any questioned costs for this item. However, without a process to verify the status of vendors or subrecipients, a risk exists that other, or future, vendors or subrecipients could be suspended or debarred.

Federal regulation 7 *CFR* 3016.35 states that grantees and subgrantees must not make any award or permit any award (subgrant or contract) at any tier to any party which is debarred or suspended or is otherwise excluded from or ineligible for participation in federal assistance programs under Executive Order No. 12549.

In response to a similar finding in the prior audit report, DNR indicated that it agreed with the recommendation and would comply. DNR added suspension and debarment disclosure language to some types of Cooperative Forestry

Assistance Program grant applications or agreements but had not added this language to all types of grant applications or agreements.

c. Reporting

DNR did not maintain sufficient documentation to support the information reported in its performance reports.

The fiscal year 2006-07 State Fire Assistance Grant performance report indicated that fiscal year 2004-05 federal funds were expended to provide fire training to 699 staff. Our review disclosed that DNR had not obtained documentation to support the number of staff trained.

Sections 40(b)(1) and 40(b)(2) of federal regulation 7 *CFR* 3016 require that performance reports comparing actual results to planned objectives for the grant period must be submitted.

d. Subrecipient Monitoring

DNR's internal control did not ensure that it satisfied the pass-through entity\* responsibilities as established by OMB Circular A-133.

OMB Circular A-133 establishes the responsibilities for pass-through entities that provide federal funds to subrecipients to carry out federal programs. DNR distributed approximately \$1.5 million to Cooperative Forestry Assistance Program subrecipients in each of fiscal years 2005-06 and 2006-07.

Our review disclosed:

- (1) DNR did not sufficiently monitor its subrecipients' activities related to the planting of purchased trees.

DNR monitors its subrecipients' activities by review of the inventories showing the location of planted trees. Our review of program files disclosed that for 3 (17%) of 18 subrecipient payments sampled, the subrecipients provided incomplete inventories for the locations of the planted trees.

\* See glossary at end of report for definition.

Section 400(d)(3) of OMB Circular A-133 requires the recipient to monitor the activities of subrecipients as necessary to ensure that federal awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved. If DNR does not sufficiently monitor the activities of subrecipients, it cannot ensure that federal awards are used for authorized purposes in compliance with laws, regulations, and provisions of contracts or grant agreements.

- (2) DNR did not ensure that its subrecipients obtained Single Audits, that it reviewed all subrecipient Single Audits, and that it issued management decisions when applicable.

Section 400(d) of OMB Circular A-133 requires that DNR ensure that subrecipients expending \$500,000 or more in federal awards during the subrecipients' fiscal year obtain a Single Audit. In addition, DNR is required to issue a management decision on its subrecipient Single Audit findings within 6 months after receipt of the subrecipient's audit report and to ensure that the subrecipient takes appropriate and timely corrective action. In order to comply with these requirements, DNR's process involves identifying whether the entity qualifies as a subrecipient, determining whether the entity expended \$500,000 or more in federal awards, and obtaining Single Audit reports and issuing management decisions within 6 months of receipt of the reports. Our review disclosed:

- (a) DNR did not ensure that it identified its subrecipients. In our review of a sample of payments to 15 grantees, we identified 5 grantees that were subrecipients not identified as subrecipients by DNR.
- (b) DNR did not always identify which subrecipients expended \$500,000 or more in federal awards during the subrecipients' fiscal year. Our sample included payments to 5 subrecipients that had been identified by DNR as subrecipients. However, DNR did not determine if 4 (80%) of the 5 subrecipients had expended \$500,000 or more in federal awards during the subrecipients' fiscal year. Our review of the OMB Federal Audit Clearinghouse database disclosed that 1 (25%) of the 4 subrecipients had submitted Single Audit reports to the Federal Audit Clearinghouse.

- (c) DNR's internal control over the review of subrecipient Single Audit reports did not ensure that it reviewed subrecipient Single Audit reports and issued management decisions within 6 months of receipt of the audit reports. Our sample included a payment to a subrecipient that DNR had identified as expending more than \$500,000 in federal awards. DNR determined that the Single Audit report for the subrecipient did not include Cooperative Forestry Assistance Program expenditures; however, DNR did not contact the subrecipient regarding the omission. As a result, DNR was unable to obtain assurance as to whether the subrecipient incurred Cooperative Forestry Assistance Program expenditures and, if so, whether the expenditures were in compliance with the federal program requirements.

In response to a similar finding in the prior audit report, DNR indicated that it agreed with the recommendation and would comply. DNR developed a process to ensure compliance with the subrecipient requirements of OMB Circular A-133. However, our review disclosed that DNR did not always follow its process.

## **RECOMMENDATIONS**

We recommend that DNR strengthen its internal control over the Cooperative Forestry Assistance Program to ensure compliance with federal laws and regulations regarding allowable costs/cost principles and reporting.

WE AGAIN RECOMMEND THAT DNR STRENGTHEN ITS INTERNAL CONTROL OVER THE COOPERATIVE FORESTRY ASSISTANCE PROGRAM TO ENSURE COMPLIANCE WITH FEDERAL LAWS AND REGULATIONS REGARDING PROCUREMENT AND SUSPENSION AND DEBARMENT AND SUBRECIPIENT MONITORING.

## **FINDING (7510803)**

### 3. Schools and Roads - Grants to States, CFDA 10.665

U.S. Department of Agriculture	CFDA 10.665: Schools and Roads - Grants to States
Award Number: None	Award Period: None
	Questioned Costs: \$0

DNR's internal control over the Schools and Roads - Grants to States Program did not ensure compliance with federal laws and regulations regarding subrecipient monitoring.

Internal control that does not ensure compliance with federal laws and regulations could result in sanctions and/or disallowances for the Schools and Roads - Grants to States Program.

DNR distributed \$5,679,470 to subrecipients for the Schools and Roads - Grants to States Program for the two-year period ended September 30, 2007.

OMB Circular A-133 establishes the responsibilities for pass-through entities that provide federal funds to subrecipients to carry out federal programs. Section 400(d) of OMB Circular A-133 requires pass-through entities to monitor the activities of the subrecipients as necessary to ensure that federal awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements. Section 400(d) of OMB Circular A-133 also requires pass-through entities to ensure that subrecipients expending \$500,000 or more in federal awards during the subrecipients' fiscal year have met the audit requirements for that fiscal year, to issue a management decision on audit findings within 6 months after receipt of the subrecipient's audit report, and to ensure that the subrecipient takes appropriate and timely corrective action. In order to comply with these requirements, DNR's process involves identifying whether the entity qualifies as a subrecipient, determining whether the entity expended \$500,000 or more in federal awards, and obtaining Single Audit reports and issuing management decisions within 6 months of receipt of the reports.

Our review of DNR's subrecipient monitoring disclosed:

- a. DNR's internal control did not ensure that its subrecipients used federal awards for authorized purposes in compliance with laws and regulations for

2 (10%) of 21 subrecipients we sampled. The first subrecipient reported to DNR that it distributed \$44,454 to the county road commission instead of the townships for the improvement of county roads within those townships. DNR noted that the subrecipient was incorrectly distributing the money but did not follow up with the subrecipient to correct the situation. The second subrecipient did not submit reports on how the funding, totaling \$17,496, was distributed. DNR sent one follow-up letter to the subrecipient but did not continue to follow up when no response was received. As a result, DNR was unable to obtain assurance as to whether these subrecipients used federal awards for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements.

In addition, Title 16, Chapter 2, Subchapter I, Section 500 of the *United States Code* requires that Schools and Roads - Grants to States Program money be expended as the State Legislature may prescribe for the benefit of the public schools and public roads of the county in which a national forest is situated. Section 141.1303 of the *Michigan Compiled Laws* prescribes that the award money be distributed to local school districts for school purposes and to townships for the improvement of county roads within those townships.

- b. DNR did not always identify which subrecipients expended \$500,000 or more in federal awards during the subrecipients' fiscal year. Our sample included payments to 18 subrecipients that had been identified by DNR as subrecipients. However, DNR did not identify whether 4 (22%) of the 18 subrecipients had expended \$500,000 or more in federal awards during the subrecipients' fiscal year. Our review of the OMB Federal Audit Clearinghouse database disclosed that only 1 (25%) of the 4 subrecipients had submitted Single Audit reports to the Federal Audit Clearinghouse.
- c. DNR's internal control over the review of subrecipient Single Audit reports did not ensure that it reviewed subrecipient Single Audit reports and issued management decisions within 6 months of receipt of the audit reports. Our sample included payments to 14 subrecipients that DNR had identified as expending more than \$500,000 in federal awards. We determined that DNR did not document obtaining or reviewing the Single Audit reports for 6 (43%) of the 14 subrecipients. The Single Audit reports for 3 (38%) of the remaining 8 subrecipients, for which DNR documented its review, did not include the expenditures for the Schools and Roads - Grants to States Program funds that

DNR granted to the subrecipient. DNR did not contact the 3 subrecipients regarding these omissions until 16 to 18 months after receipt of the audit reports.

In response to a similar finding in the prior audit report, DNR indicated that it agreed with the recommendation and would comply. DNR developed a process to ensure compliance with the subrecipient requirements of OMB Circular A-133. However, our review determined that DNR did not always follow its process.

**RECOMMENDATION**

WE AGAIN RECOMMEND THAT DNR IMPROVE ITS INTERNAL CONTROL OVER THE SCHOOLS AND ROADS - GRANTS TO STATES PROGRAM TO ENSURE COMPLIANCE WITH FEDERAL LAWS AND REGULATIONS REGARDING SUBRECIPIENT MONITORING.

**FINDING (7510804)**

4. Fish and Wildlife Cluster, CFDA 15.605 and 15.611

U.S. Department of the Interior	CFDA 15.605 and 15.611: Fish and Wildlife Cluster
Award Number:	Award Period:
F-62-D-19	10/01/2005 - 09/30/2006
F-62-D-20	10/01/2006 - 09/30/2007
F-80-R-7	10/01/2005 - 09/30/2006
F-80-R-8	10/01/2006 - 09/30/2007
E-81-R-7	10/01/2005 - 09/30/2006
E-81-R-8	10/01/2006 - 09/30/2007
F-82-R-6	10/01/2005 - 09/30/2006
F-82-R-7	10/01/2006 - 09/30/2007
F-87-B-1	10/01/2005 - 12/31/2007
F-89-D-1	03/01/2006 - 09/30/2010
F-90-D-1	06/01/2007 - 12/31/2008
FW-4-C-18	10/01/2006 - 09/30/2007
W-120-S-43	10/01/2005 - 09/30/2007
W-120-S-44	10/01/2006 - 09/30/2007
W-147-R-4	10/01/2005 - 09/30/2006
W-147-R-5	10/01/2006 - 09/30/2007
W-148-M-2	10/01/2005 - 09/30/2006
W-148-M-3	10/01/2006 - 09/30/2007
W-149-P-2	10/01/2005 - 09/30/2006
W-149-P-3	10/01/2006 - 09/30/2007
W-150-D-2	10/01/2005 - 09/30/2006
W-150-D-3	10/01/2006 - 09/30/2007
	Questioned Costs: \$2,501

DNR's internal control over the Fish and Wildlife Cluster did not ensure compliance with federal laws and regulations regarding allowable costs/cost principles. Our review also disclosed significant deficiencies in internal control related to procurement and suspension and debarment.

Internal control that does not ensure compliance with federal laws and regulations could result in sanctions and/or disallowances for the Fish and Wildlife Cluster.

Federal expenditures for the Fish and Wildlife Cluster totaled \$37,030,760 for the two-year period ended September 30, 2007. We identified known questioned costs of \$2,501 and known and likely questioned costs totaling \$17,318.

Our review of expenditures and program files disclosed:

a. Allowable Costs/Cost Principles

DNR's internal control over payroll charges did not ensure that time and activity records were certified by the employee.

Our review of 20 payroll transactions sampled disclosed 3 (15%) transactions for two employees who did not enter their own time into DCDS or complete and maintain hard copy time and activity records. DNR did not have a compensating control to ensure that the employees certified (via manual signature or electronic entry) their hours and activities that were entered on their behalf by another employee. As a result, DNR could not ensure that the employees certified their hours and activities charged to the Fish and Wildlife Cluster. We identified known questioned costs totaling \$2,501 and known and likely questioned costs of \$17,318 related to these payroll transactions.

Appendix B, section 8 of federal regulation 2 *CFR* 225 requires employees who are charged to multiple activities or cost objectives to document and maintain personnel activity reports or equivalent documentation that supports the distribution of their payroll costs. Personnel activity reports or equivalent documentation must be signed by the employee. In addition, DNR policy 15.01-02, Payroll Costs Charged to Federal Aid Grants, requires employees to prepare time sheets or to record their time in DCDS.

b. Procurement and Suspension and Debarment

DNR did not have a process to ensure that vendors were not on the federal Excluded Parties List System.

Our review of 13 contracts sampled disclosed that none of the contracts contained language that informed the vendors that, by signing the contract, they were certifying that they have not been suspended or debarred. DNR did not have other controls in place to verify that vendors were not on the federal Excluded Parties List System.

We reviewed the federal Excluded Parties List System and verified that none of the vendors in our sample of Fish and Wildlife Cluster expenditures were suspended or debarred during the respective fiscal years. As a result, we have not reported any questioned costs for this item. However, without a process to verify the status of vendors, a risk exists that other, or future, vendors could be suspended or debarred.

Federal regulation 43 *CFR* 12.75 states that grantees and subgrantees must not make any award or permit any award (subgrant or contract) at any tier to any party which is debarred or suspended or is otherwise excluded from or ineligible for participation in federal assistance programs under Executive Order No. 12549.

In response to a similar finding in the prior audit report, DNR indicated that it agreed with the recommendation and would comply. DNR informed us that it has changed the language in newly created contracts that became effective subsequent to the audit period.

**RECOMMENDATIONS**

We recommend that DNR strengthen its internal control over the Fish and Wildlife Cluster to ensure compliance with federal laws and regulations regarding allowable costs/cost principles.

WE AGAIN RECOMMEND THAT DNR IMPROVE ITS INTERNAL CONTROL OVER THE FISH AND WILDLIFE CLUSTER TO ENSURE COMPLIANCE WITH FEDERAL LAWS AND REGULATIONS REGARDING PROCUREMENT AND SUSPENSION AND DEBARMENT.

## **FINDING (7510805)**

### 5. State Wildlife Grants, CFDA 15.634

U.S. Department of the Interior	CFDA 15.634: State Wildlife Grants
Award Number:	Award Period:
T-1-P-3	09/16/2004 - 06/30/2007
T-1-P-4	09/16/2005 - 06/30/2007
T-2-M-2	10/01/2003 - 06/30/2007
T-3-P-1	05/30/2005 - 12/31/2005
T-4-C-1	10/01/2005 - 09/30/2006
T-4-C-2	10/01/2006 - 09/30/2007
T-5-T-1	09/22/2005 - 09/30/2007
T-5-T-2	09/22/2005 - 09/30/2007
T-6-M-1	09/22/2005 - 09/30/2007
T-6-M-2	09/22/2005 - 09/30/2007
T-7-R-1	10/01/2005 - 09/30/2007
T-8-1	03/30/2006 - 12/31/2006
	Questioned Costs: \$947,069

DNR's internal control over the State Wildlife Grants Program did not ensure compliance with federal laws and regulations regarding activities allowed or unallowed; allowable costs/cost principles; and matching, level of effort, and earmarking. Our review disclosed material weaknesses in internal control and material noncompliance\* with compliance requirements related to matching, level of effort, and earmarking. As a result, we issued a qualified opinion on compliance with federal laws and regulations for the State Wildlife Grants Program. Our review also disclosed significant deficiencies in internal control related to procurement and suspension and debarment.

Internal control that does not ensure compliance with federal laws and regulations could result in sanctions and/or disallowances for the State Wildlife Grants Program.

Federal expenditures for the State Wildlife Grants Program totaled \$5,566,214 for the two-year period ended September 30, 2007. We identified known questioned costs of \$947,069 and known and likely questioned costs totaling \$970,249.

\* See glossary at end of report for definition.

Our review of expenditures and program files disclosed:

a. Activities Allowed or Unallowed

DNR's internal control did not ensure compliance with federal laws and regulations regarding university contract payments for the State Wildlife Grants Program.

During the audit period, DNR paid 7 universities a total of approximately \$3.1 million to conduct activities for the State Wildlife Grants Program. Our sample of State Wildlife Grants Program expenditures included payments to 5 (71%) of the 7 universities. Our review of the 5 contract files disclosed that DNR had not obtained and reviewed 1 (20%) of the 5 required annual reports.

Section 300(b) of OMB Circular A-133 requires DNR to maintain internal control over federal programs that provides reasonable assurance that DNR is managing federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its federal programs. To obtain reasonable assurance, DNR informed us that each university contract requires the university to submit an annual report detailing the activities performed and that DNR personnel review these annual reports to monitor the universities' compliance with the federal program requirements.

b. Allowable Costs/Cost Principles

DNR's internal control did not ensure compliance with federal laws and regulations regarding certification of employees who worked on only one federal award for the State Wildlife Grants Program.

We determined that one employee worked solely on the State Wildlife Grants Program during our audit period. We reviewed payroll charges for two judgmentally selected payroll periods for this employee and noted that DNR did not complete a semi-annual certification that would have covered one of the payroll periods. As a result, we identified known questioned costs of \$1,924 for the payroll costs incurred during that payroll period and known and likely questioned costs of \$25,104 for the total payroll costs associated with the payroll periods ended April 8, 2006 through October 7, 2006 in which a certification was not completed for this employee.

Appendix B, section 8.h.(3) of federal regulation 2 *CFR* 225 requires that, where employees are expected to work solely on a single federal award or cost objective, charges for their salaries and wages will be supported by periodic certifications that the employees worked solely on that program for the period covered by the certification. These certifications will be prepared at least semi-annually and will be signed by the employee or supervisory official having firsthand knowledge of the work performed by the employee.

c. Matching, Level of Effort, and Earmarking

DNR did not document how it determined the value of third party in-kind contributions\* and the third party's agreement to the in-kind contribution used to satisfy the State Wildlife Grants Program matching requirements.

DNR included approximately \$1.5 million in third party in-kind contributions to satisfy matching requirements for the State Wildlife Grants Program. DNR informed us that \$1.2 million (80%) of these contributions consisted of a waiver (in lieu of charging DNR) of the indirect costs incurred by universities it contracted with to conduct research projects for the State Wildlife Grants Program. We reviewed the contracts applicable to one of these universities and noted that the contract did not document DNR's and the university's agreement to the waiver. Also, we reviewed payments applicable to the university and noted that DNR did not document how the value of the indirect costs waived by the university were determined. As a result, we identified known questioned costs of \$945,145 for the third party in-kind matching contributions related to indirect costs waived by this university.

Federal regulation 43 *CFR* 12.64(6) states that costs and third party in-kind contributions counting towards satisfying a cost sharing or matching requirement must be verifiable from the records of grantees and subgrantees or cost-type contractors. These records must show how the value placed on third party in-kind contributions was derived.

d. Procurement and Suspension and Debarment

DNR did not have a process to ensure that vendors were not on the federal Excluded Parties List System.

\* See glossary at end of report for definition.

Our review of 15 contracts sampled disclosed that none of the contracts contained language that informed the vendors that, by signing the contract, they were certifying that they have not been suspended or debarred. DNR did not have other controls in place to verify that vendors were not on the federal Excluded Parties List System.

We reviewed the federal Excluded Parties List System and verified that none of the vendors in our sample of State Wildlife Grants Program expenditures were suspended or debarred during the respective fiscal years. As a result, we have not reported any questioned costs for this item. However, without a process to verify the status of vendors, a risk exists that other, or future, vendors could be suspended or debarred.

Federal regulation 43 *CFR* 12.75 states that grantees and subgrantees must not make any award or permit any award (subgrant or contract) at any tier to any party which is debarred or suspended or is otherwise excluded from or ineligible for participation in federal assistance programs under Executive Order No. 12549.

In response to a similar finding in the prior audit report, DNR indicated that it agreed with the recommendation and would comply. DNR informed us that it has changed the language in newly created contracts that became effective subsequent to the audit period.

## **RECOMMENDATIONS**

We recommend that DNR strengthen its internal control over the State Wildlife Grants Program to ensure compliance with federal laws and regulations regarding activities allowed or unallowed; allowable costs/cost principles; and matching, level of effort, and earmarking.

WE AGAIN RECOMMEND THAT DNR STRENGTHEN ITS INTERNAL CONTROL OVER THE STATE WILDLIFE GRANTS PROGRAM TO ENSURE COMPLIANCE WITH FEDERAL LAWS AND REGULATIONS REGARDING PROCUREMENT AND SUSPENSION AND DEBARMENT.

## **FINDING (7510806)**

### 6. Outdoor Recreation - Acquisition, Development and Planning, CFDA 15.916

U.S. Department of the Interior	CFDA 15.916: Outdoor Recreation - Acquisition, Development and Planning
Award Number: Various	Award Period: Various
	Questioned Costs: \$0

DNR's internal control over the Outdoor Recreation - Acquisition, Development and Planning Program did not ensure compliance with federal laws and regulations regarding allowable costs/cost principles, cash management, subrecipient monitoring, and reporting.

Internal control that does not ensure compliance with federal laws and regulations could result in sanctions and/or disallowances for the Outdoor Recreation - Acquisition, Development and Planning Program.

Federal expenditures for the Outdoor Recreation - Acquisition, Development and Planning Program totaled \$6,301,825 for the two-year period ended September 30, 2007.

Our review of expenditures and program files disclosed:

#### a. Allowable Costs/Cost Principles

DNR's internal control did not ensure that Outdoor Recreation - Acquisition, Development and Planning Program expenditures met allowable cost principles in accordance with federal regulations or the indirect rate approved by DNR's cognizant agency:

- (1) DNR's controls over payroll charges did not ensure that time and activity records were certified by the employee.

Our review of 16 payroll transactions sampled for 9 employees disclosed 2 (13%) transactions for two employees who did not enter their own time into DCDS or complete and maintain hard copy time and activity records. We reviewed the remaining 57 payroll transactions charged directly to the Outdoor Recreation - Acquisition, Development and Planning Program for these two employees during our audit period and noted an additional 12

(21%) transactions in which the employees did not enter their own time. DNR did not have a compensating control to ensure that the employees certified (via manual signature or electronic entry) their hours and activities that were entered on their behalf by another employee. As a result, DNR could not ensure that the employees certified their hours and activities charged to the Outdoor Recreation - Acquisition, Development and Planning Program.

Appendix B, section 8 of federal regulation 2 *CFR* 225 requires employees who are charged to multiple activities or cost objectives to document and maintain personnel activity reports or equivalent documentation that supports the distribution of their payroll costs. Personnel activity reports or equivalent documentation must be signed by the employee. Also, DNR policy 15.01-02, Payroll Costs Charged to Federal Aid Grants, requires employees to prepare time sheets or to record their time in DCDS.

- (2) DNR did not properly calculate the indirect cost rate allocation for the Outdoor Recreation - Acquisition, Development and Planning Program based on the federal approved methodology.

The federal government approved DNR's methodology to recover indirect costs throughout the year based on a rate applied to the federal portion (50%) of estimated salary and wage expenditures and adjusted as necessary to account for the prior year's indirect costs that were overrecovered or underrecovered based on actual expenditures.

Our review disclosed that DNR's indirect cost rate was inadvertently doubled as a result of an error in the formula that applied the indirect cost rate to the total State and federally funded salary and wage expenditures (100%) rather than just the federal portion. We did not cite questioned costs because overrecoveries were adjusted in subsequent years.

b. Cash Management

DNR did not properly calculate the indirect cost rate allocation for the Outdoor Recreation - Acquisition, Development and Planning Program based on the federal approved methodology as discussed in the allowable costs/cost principles section (part a.(2)) of this finding.

DNR's indirect cost rate was inadvertently doubled, and as a result, DNR overdrew for indirect costs for each of its draws of federal funds made throughout the fiscal year. Although DNR adjusted the subsequent year's estimate with the prior year's overrecoveries or underrecoveries based on actual expenditures, DNR's overdraws resulted in excess interest earnings for its indirect cost recoveries. We were unable to determine the amount of excess funds drawn and interest earned.

c. Subrecipient Monitoring

DNR's internal control did not ensure that it satisfied the pass-through entity responsibilities as established by OMB Circular A-133.

OMB Circular A-133 establishes the responsibilities for pass-through entities that provide federal funds to subrecipients that carry out federal programs. DNR distributed \$2.2 million and \$1.1 million to Outdoor Recreation - Acquisition, Development and Planning Program subrecipients in fiscal years 2005-06 and 2006-07, respectively. Our review disclosed:

- (1) DNR's internal control did not always ensure that it informed subrecipients of the *CFDA* title and number for federal funds passed through to the subrecipients.

Our sample included payments to 15 subrecipients. DNR did not inform 1 (7%) of the subrecipients of the *CFDA* title and number for federal funds passed through to the subrecipients.

OMB Circular A-133 requires pass-through entities to identify federal awards by informing each subrecipient of the *CFDA* title and number, award name and number, award year, and name of the federal awarding agency and if the award is for research and development.

- (2) DNR did not ensure that its subrecipients obtained Single Audits, that it reviewed all subrecipient Single Audits, and that it issued management decisions when applicable.

Section 400(d) of OMB Circular A-133 requires pass-through entities to ensure that subrecipients expending \$500,000 or more in federal awards during the subrecipients' fiscal year have met the audit requirements for

that fiscal year, to issue a management decision on audit findings within 6 months after receipt of the subrecipient's audit report, and to ensure that the subrecipient takes appropriate and timely corrective action. In order to comply with these requirements, DNR's process involves identifying whether the entity qualifies as a subrecipient, determining whether the entity expended \$500,000 or more in federal awards, and obtaining Single Audit reports and issuing management decisions within 6 months of receipt of the reports. We noted:

- (a) DNR did not always identify which subrecipients expended \$500,000 or more in federal awards during the subrecipients' fiscal year. Our sample included payments to 5 subrecipients that had been identified by DNR as subrecipients. However, DNR did not identify whether 3 (60%) of the 5 subrecipients had expended \$500,000 or more in federal awards during the subrecipients' fiscal year. Our review of the OMB Federal Audit Clearinghouse database disclosed that 3 (60%) of the 5 subrecipients had submitted Single Audit reports to the Federal Audit Clearinghouse.
- (b) DNR's internal control over the review of subrecipient Single Audit reports did not ensure that it reviewed subrecipient Single Audit reports and issued management decisions within 6 months of receipt of the audit reports. Our review disclosed that DNR had not reviewed any of the 3 subrecipients' Single Audit reports that had been submitted to the OMB Federal Audit Clearinghouse. As a result, DNR was unable to issue its management decision as to whether the subrecipient should take corrective action.

In response to similar findings in the prior audit report, DNR indicated that it agreed with the recommendations and would comply. DNR developed a process to ensure compliance with the subrecipient requirements of OMB Circular A-133. However, our review determined that DNR did not always follow its process.

d. Reporting

DNR's internal control did not ensure compliance with the federal laws and regulation regarding post-completion inspection reports.

We determined from our review of the federal report that tracks when inspection reports are due and overdue that 834 post-completion inspection reports were overdue at the end of fiscal year 2006-07.

Chapter 675.9, Section 5 of the Land and Water Conservation Fund Grants-in-Aid Manual requires that post-completion inspection reports be submitted to the National Park Service within five years after the final billing for a project and every five years, thereafter.

In response to a similar finding in the prior audit report, DNR indicated that it agreed with the recommendation and would comply. However, our review disclosed that DNR had not established an effective process to track the status of projects so that it could complete post-completion inspections reports by the inspection deadline.

**RECOMMENDATIONS**

We recommend that DNR strengthen its internal control over the Outdoor Recreation - Acquisition, Development and Planning Program to ensure compliance with federal laws and regulations regarding allowable costs/cost principles and cash management.

WE AGAIN RECOMMEND THAT DNR IMPROVE ITS INTERNAL CONTROL OVER THE OUTDOOR RECREATION - ACQUISITION, DEVELOPMENT AND PLANNING PROGRAM TO ENSURE COMPLIANCE WITH FEDERAL LAWS AND REGULATIONS REGARDING SUBRECIPIENT MONITORING AND REPORTING.

**FINDING (7510807)**

7. Boating Safety Financial Assistance, CFDA 97.012

U.S. Department of Homeland Security	CFDA 97.012: Boating Safety Financial Assistance
Award Number: 16.01.26 17.01.26	Award Period: 10/01/2005 - 09/30/2006 10/01/2006 - 09/30/2007
	Questioned Costs: \$1,753,978

DNR's internal control over the Boating Safety Financial Assistance Program did not ensure compliance with federal laws and regulations regarding activities allowed or unallowed, allowable costs/cost principles, cash management, period of

availability, reporting, and subrecipient monitoring. Our review disclosed material weaknesses in internal control and material noncompliance with compliance requirements related to activities allowed or unallowed, allowable costs/cost principles, and period of availability. As a result, we issued a qualified opinion on compliance with federal laws and regulations for the Boating Safety Financial Assistance Program. Our review also disclosed significant deficiencies in internal control related to procurement and suspension and debarment.

Internal control that does not ensure compliance with federal laws and regulations could result in sanctions and/or disallowances for the Boating Safety Financial Assistance Program.

Federal expenditures for the Boating Safety Financial Assistance Program totaled \$13,443,259 for the two-year period ended September 30, 2007. We identified known questioned costs of \$1,753,978 and known and likely questioned costs totaling \$1,775,102.

Our review of expenditures and program files disclosed:

a. Activities Allowed or Unallowed

DNR's internal control did not ensure that expenditures incurred were for activities allowed. As discussed in the allowable costs/cost principles section (part b.) of this finding, DNR used Boating Safety Financial Assistance Program funds to finance a project not identified in its application to the awarding agency. We questioned costs totaling \$591,530 in the allowable costs/cost principles section (part b.(2)) of this finding.

b. Allowable Costs/Cost Principles

DNR's internal control did not ensure that Boating Safety Financial Assistance Program expenditures met allowable cost principles of federal regulation 2 *CFR* 225. As a result, we identified known questioned costs totaling \$1,582,926, of which \$971,963 is questioned in the period of availability section (part d.(1)) of this finding. Our audit tests disclosed:

- (1) As discussed in the period of availability section (part d.) of this finding, DNR improperly charged the grant period ended September 30, 2006 for costs not incurred during the grant period. We identified known questioned costs totaling \$1,563,493, of which \$591,530 is questioned in

part b.(2) of this finding and \$971,963 is questioned in part d.(1) of this finding.

Appendix A, Section C of federal regulation 2 *CFR* 225 requires that costs conform to any limitations or exclusions set forth in the terms and conditions of the federal award. DNR's fiscal year 2005-06 grant application and agreement specify a funding period ended September 30, 2006. Appendix A, Section C of federal regulation 2 *CFR* 225 also requires that costs be adequately documented.

- (2) DNR did not obtain prior approval of the awarding agency for 1 (20%) of 5 public access site projects reviewed. As a result, we identified known questioned costs of \$591,530 for expenditures incurred for this project during our audit period.

Appendix A, Section C of federal regulation 2 *CFR* 225 requires that costs conform to any limitations or exclusions set forth in the terms and conditions of the federal award or other governing regulations as to types or amounts of cost items. The State Recreational Boating Safety Programs State Guide specifies that costs for acquisition, construction, repair, and maintenance of public access sites identified in the State application approved by the U.S. Coast Guard are allowable.

- (3) DNR improperly charged 100% of payroll expenditures for 2 (20%) of 10 employees sampled to the Boating Safety Financial Assistance Program. DNR estimated that 10% of these employees' time was not spent on Boating Safety Financial Assistance related activities. As a result, we identified known and likely questioned costs totaling \$19,433.

Appendix B, section 8 of federal regulation 2 *CFR* 225 requires employees who work on multiple activities or cost objectives to document and maintain personnel activity reports or equivalent documentation that supports the distribution of their payroll costs. Personnel activity reports must reflect an after-the-fact distribution of the actual activity of each employee. In addition, DNR policy 15.01-02, Payroll Costs Charged to Federal Aid Grants, requires that employees enter their time and account coding based on actual hours worked.

c. Cash Management

DNR's internal control over the Boating Safety Financial Assistance Program did not ensure that it sufficiently minimized the time elapsing between expenditure of funds and the request for federal grant reimbursement.

As discussed in the period of availability section (part d.) of this finding, DNR drew down fiscal year 2005-06 grant funds for obligations not yet incurred or liquidated.

Federal regulation 49 *CFR* 18.21 requires DNR to minimize the time elapsing between the transfer of funds and disbursement in accordance with federal regulation 31 *CFR* 205. In addition, Department of Management and Budget Administrative Guide procedure 1210.06 requires State agencies to request funds as close as administratively feasible to the actual cash outlay by the State and to limit requests to the minimum amounts needed.

d. Period of Availability

DNR's internal control over the Boating Safety Financial Assistance Program did not ensure compliance with federal laws and regulations regarding period of availability of federal funds. Our review disclosed:

- (1) DNR improperly charged the grant period ended September 30, 2006 for costs not incurred during the grant period. As a result, we identified known questioned costs of \$1,563,493, of which \$591,530 is questioned in the allowable costs/cost principles section (part b.(2)) of this finding.
- (2) DNR liquidated obligations from the Boating Safety Financial Assistance Program from 4 days to 213 days after the 90-day requirement. As a result, we identified known questioned costs of \$190,485 and known and likely questioned costs totaling \$192,176.

Federal regulation 49 *CFR* 18.23 states that, where the federal awarding agency specifies a funding period, a grantee may only charge costs to the award resulting from obligations that occurred during the funding period. Also, a grantee must liquidate all obligations incurred under the award not later than 90 days after the end of a funding period to coincide with the submission of the annual financial status report.

e. Procurement and Suspension and Debarment

DNR did not have a process to ensure that vendors or subrecipients were not on the federal Excluded Parties List System.

Our review disclosed that 10 (71%) of 14 contracts, applications, or grant agreements sampled did not include language that informed the vendors or subrecipients that, by signing the contract, application, or grant agreement, they were certifying that they have not been suspended or debarred. In addition, DNR did not have other controls in place to verify that vendors and subrecipients were not on the federal Excluded Parties List System.

We reviewed the federal Excluded Parties List System and verified that none of the vendors or subrecipients in our sample of Boating Safety Financial Assistance Program expenditures were suspended or debarred during the respective fiscal years. As a result, we have not reported any questioned costs for this item. However, without a process to verify the status of vendors or subrecipients, a risk exists that other, or future, vendors or subrecipients could be suspended or debarred.

Federal regulation 49 *CFR* 18.35 states that grantees and subgrantees must not make any award or permit any award (subgrant or contract) at any tier to any party which is debarred or suspended or is otherwise excluded from or ineligible for participation in federal assistance programs under Executive Order No. 12549.

f. Reporting

DNR's internal control did not ensure that Boating Safety Financial Assistance Program financial status reports were accurate and that they agreed with the accounting records.

DNR reported expenditure outlays of \$1,563,493 on its fiscal year 2005-06 financial status report that had not been incurred as of September 30, 2006. In addition, DNR reported \$0 unobligated funds for the reporting period ended September 30, 2006. However, as identified in the period of availability section (part d.(1)) of this finding, DNR had not expended or obligated the grant funds as of September 30, 2006.

Federal regulation 49 *CFR* 18.20 requires that DNR's federal financial reports reflect accurate disclosure of a program's financial activities. Federal regulation 49 *CFR* 18.41 requires DNR to use specific financial status reports to report on the status of funds. The financial status report instructions indicate that the expenditure outlays should include the sum of actual cash disbursements for direct charges for goods and services and amounts owed for goods received or services performed. The unobligated funds amount is the remaining federal award amount for which funds have not been expended or obligated.

g. Subrecipient Monitoring

DNR's internal control did not ensure that it satisfied the pass-through entity responsibilities as established by OMB Circular A-133.

OMB Circular A-133 establishes the responsibilities for pass-through entities that provide federal funds to subrecipients to carry out federal programs. Section 400(d) of OMB Circular A-133 requires pass-through entities to ensure that subrecipients expending \$500,000 or more in federal awards during the subrecipients' fiscal year have met the audit requirements for that fiscal year, to issue a management decision on audit findings within 6 months after receipt of the subrecipient's audit report, and to ensure that the subrecipient takes appropriate and timely corrective action. In order to comply with these requirements, DNR's process involves identifying whether the entity qualifies as a subrecipient, determining whether the entity expended \$500,000 or more in federal awards, and obtaining Single Audit reports and issuing management decisions within 6 months of receipt of the reports.

Our review disclosed:

- (1) DNR did not always identify which subrecipients expended \$500,000 or more in federal awards during the subrecipients' fiscal year. Our sample included payments to 2 subrecipients that had been identified by DNR as subrecipients. However, DNR did not identify whether 1 (50%) of the 2 subrecipients had expended \$500,000 or more in federal awards during the subrecipient's fiscal year.
- (2) DNR's internal control over the review of subrecipient Single Audit reports did not ensure that it reviewed subrecipient Single Audit reports and

issued management decisions within 6 months of receipt of the audit reports. Our sample included a payment to one subrecipient that DNR had identified as expending more than \$500,000 in federal awards. DNR determined that the Single Audit report for the subrecipient did not include Boating Safety Financial Assistance Program expenditures; however, DNR did not contact the subrecipient regarding the omission. As a result, DNR was unable to issue its management decision as to whether the subrecipient should take corrective action.

### **RECOMMENDATION**

We recommend that DNR improve its internal control over the Boating Safety Financial Assistance Program to ensure compliance with federal laws and regulations regarding activities allowed or unallowed, allowable costs/cost principles, cash management, period of availability, procurement and suspension and debarment, reporting, and subrecipient monitoring.

**The status of the findings related to federal awards that were reported in prior Single Audits is disclosed in the summary schedule of prior audit findings.**

## OTHER SCHEDULES

DEPARTMENT OF NATURAL RESOURCES  
Summary Schedule of Prior Audit Findings  
As of December 30, 2008

**PRIOR AUDIT FINDINGS RELATED TO THE FINANCIAL STATEMENTS AND FINANCIAL SCHEDULES**

Audit Findings That Have Been Fully Corrected:

**Audit Period:** October 1, 2003 through September 30, 2005

**Finding Number:** 750601

**Finding Title:** Retail Sales System Controls

**Finding:** The Department of Natural Resources' (DNR's) controls for the retail sales of licenses did not minimize the risk of fraud or misuse of voided licenses.

**Comments:** DNR has implemented a shortened window for agent-initiated sales voids.

**Audit Period:** October 1, 2001 through September 30, 2003

**Finding Number:** 750402

**Finding Title:** Retail Sales System Controls

**Finding:** DNR's internal control for retail sales did not minimize the risk of fraud or misuse of voided licenses.

**Comments:** See comments to Finding 750601.

**Audit Period:** October 1, 2003 through September 30, 2005

**Finding Number:** 750602

**Finding Title:** Service Organization Controls

**Finding:** DNR did not obtain sufficient assurances regarding the internal control of the service organizations that operated the Retail Sales System and the Central Reservation System.

**Comments:** The Retail Sales System has been upgraded. DNR has received completed SAS 70\* internal control reviews from the vendors.

**Audit Period:** October 1, 2003 through September 30, 2005

**Finding Number:** 750604

**Finding Title:** Cash Management

**Finding:** DNR's controls did not ensure compliance with federal and State cash management standards.

**Comments:** A memorandum was sent from DNR's Forest, Mineral and Fire Management Division (FMFM) to its Budget and Support Services (BSS) on May 24, 2006 stating that FMFM staff will have eligible federal charges posted to appropriate federal accounts by the 15th of each month. The Federal Aid Section of BSS may bill any charges in these accounts as they are audited before being placed in those accounts. FMFM staff will notify the Federal Aid Section prior to the 15th of any month if the billing should not be processed on the 15th.

A memorandum was sent from DNR's Wildlife Division to DNR's Internal Audit on May 9, 2006 stating that university contracts are billed on a quarterly basis; therefore, all match documentation will be provided to the Federal Aid Section prior to first quarter payments and updated as new contracts are added during the fiscal year. This allows the Federal Aid Section to have the match documentation to bill university contracts quarterly.

**Audit Period:** October 1, 2003 through September 30, 2005

**Finding Number:** 750605

**Finding Title:** Monitoring of Gas Royalty Revenue

\* See glossary at end of report for definition.

**Finding:** DNR, in coordination with the Department of Management and Budget (DMB), needs to strengthen its controls to ensure compliance with provisions of the State's gas royalty revenue agreements with a third party purchaser.

**Comments:** DNR worked with DMB on drafting the invitation to bid to ensure that the accounting firm contract would be long enough to provide the reports through the point when production reaches 67.3 billion cubic feet. The contract for the new accounting firm was approved in October 2005 and is for three years with an option to extend, if needed. In addition, the DNR Office of Financial Services has established a liability account for anticipated future payments to the buyer. After revenue is posted each month, FMFM staff provide the Office of Financial Services an estimated revenue amount for the wells associated with the agreement. Payment to the buyer will be based upon the acceptance of the contracted accounting firm reports and in accordance with the agreed-upon schedule with the buyer. DNR believes that it has strengthened its controls to the extent possible and is in compliance with this recommendation.

Audit Findings Not Corrected or Partially Corrected:

**Audit Period:** October 1, 2003 through September 30, 2005

**Finding Number:** 750603

**Finding Title:** Controls Over Accounts Payable

**Finding:** DNR's controls over recording accounts payable for the Michigan Natural Resources Trust Fund (MNRTF) and General Fund expenditures did not ensure that expenditures were recorded in the proper fiscal year.

**Comments:** Accounts payable have been set up for fiscal years 2005-06 and 2006-07.

## PRIOR AUDIT FINDINGS RELATED TO FEDERAL AWARDS

### Audit Findings That Have Been Fully Corrected:

**Audit Period:** October 1, 2003 through September 30, 2005

**Finding Number:** 750610

**Finding Title:** Cash Management

**Finding:** DNR's controls did not ensure compliance with federal and State cash management standards.

**Comments:** See Finding 750604 with the prior audit findings related to the financial statements and financial schedules.

### Audit Findings Not Corrected or Partially Corrected:

**Audit Period:** October 1, 2003 through September 30, 2005

**Finding Number:** 750606

**Finding Title:** Cooperative Forestry Assistance, *CFDA* 10.664

**Finding:** DNR's controls over the Cooperative Forestry Assistance Program did not ensure compliance with federal laws and regulations regarding reporting and subrecipient monitoring.

**Comments:** FMFM made appropriate adjustments to its performance reporting process beginning with the fiscal year 2005-06 grant cycle to ensure that the total number of applications approved to be funded under the award is accurate. Also, FMFM made adjustments to its grant agreement form to ensure that DNR is informing subrecipients of all required federal grant information in accordance with U.S. Office of Management and Budget (OMB) Circular A-133.

**Audit Period:** October 1, 2003 through September 30, 2005  
**Finding Number:** 750607  
**Finding Title:** Outdoor Recreation - Acquisition, Development and Planning,  
*CFDA 15.916*

**Finding:** DNR's controls over the Outdoor Recreation - Acquisition, Development and Planning Program did not ensure compliance with federal laws and regulations regarding reporting, subrecipient monitoring, and special tests and provisions.

**Comments:**

- a. Grants Management has a process in place to conduct post-completion inspections and to respond to any findings from the inspections. In addition, Grants Management has a post-completion spreadsheet system to track the status of projects to determine when post-completion inspections were performed and when they are due again. Further, a process is in place for review of subrecipients' financial reports to determine if subrecipients' Single Audit reports include all required information.
- b. The Land and Water Conservation Fund grant agreement has the required federal notification information on the front (first) page of the grant agreement.
- c. Grants Management has a conversion tracking and resolution process in place. Written procedures for conversions have been created. Written documentation of the conversion process has been created. A conversion document for information gathering has been created.

**Audit Period:** October 1, 2003 through September 30, 2005  
**Finding Number:** 750608  
**Finding Title:** Subrecipient Monitoring

**Finding:** DNR's controls over federal programs did not ensure compliance with federal laws and regulations regarding subrecipient monitoring.

**Comments:** DNR has established a process to help ensure compliance with federal laws and regulations regarding subrecipient monitoring. DNR uses the best information available to identify all subrecipients of federal aid. DNR has accessed and reviewed Michigan counties' and other subrecipients' audit reports on the OMB Federal Audit Clearinghouse database and the Department of Treasury local audit reports database and has reviewed hard copy financial statements to make a preliminary judgment on whether a Single Audit has been filed or is required to be filed.

Staffing constraints require prioritizing reviews of subrecipients. Currently, as staff time permits, DNR will continue to pursue identifying all subrecipients of DNR passed-through federal aid for fiscal years 2004-05, 2005-06, 2006-07, and beyond. Subsequently, DNR will ensure that the audit requirements have been met.

**Audit Period:** October 1, 2003 through September 30, 2005

**Finding Number:** 750609

**Finding Title:** Procurement and Suspension and Debarment

**Finding:** DNR's controls over federal programs did not ensure compliance with federal laws and regulations regarding procurement and suspension and debarment.

**Comments:** Regarding the debarred vendor requirement, DNR will incorporate the necessary language in its contracts.

DEPARTMENT OF NATURAL RESOURCES

Corrective Action Plan  
As of December 29, 2008

**FINDINGS RELATED TO THE FINANCIAL STATEMENTS AND FINANCIAL SCHEDULES**

**Finding Number:** 7510801

**Finding Title:** Internal Control Over Accounts Payable

**Management Views:** With respect to the Sleeper Lake estimated liability in Finding 1.a., the Department of Natural Resources (DNR) wishes to make the following observations: The account payable for the Sleeper Lake fire was appropriately established using the rates and hours provided by the Department of Military and Veterans Affairs (DMVA). The estimated account payable was established at the calculated rate to ensure that funds would be available to pay for the expenditures related to the event. Subsequently, a billing from DMVA was received for a portion of the costs it had incurred. DNR did not attempt to confirm with DMVA that this was a final billing because the amount was much less than the full amount incurred. Moreover, it was too late in the closing to verify and formalize to what extent additional billings might occur. In addition, this was just one component of the total estimated liability and uncertainties remained with respect to other components. Finally, even if DMVA decided not to bill for all of the costs incurred, the liability existed at year-end and the expenditures were indeed incurred. Recording the forgiveness of the liability as revenue in the subsequent year was appropriate.

The other account payable transactions in Finding 1.a. were also established based on the information DNR was able to obtain prior to the end of the fiscal year.

DNR agrees with Finding 1.b. and will comply with the corresponding recommendation.

**Corrective Action:** DNR will institute an additional level of review for all individual accounts payable in excess of \$500,000.

**Anticipated Completion Date:** November 21, 2008

**Responsible Individual:** Joseph Frick, Chief, Financial Services

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#### FINDINGS RELATED TO FEDERAL AWARDS

**Finding Number:** 7510802

**Finding Title:** Cooperative Forestry Assistance, *CFDA* 10.664

**Management Views:** DNR agrees with Findings 2.a., 2.c., 2.d.(1) and 2.d.(2)(a) and will comply with the corresponding recommendations.

DNR agrees with Finding 2.b. that additional controls to deter payments to vendors on the federal suspension and debarment list can be further improved.

With respect to Findings 2.d.(2)(b) and 2.d.(2)(c), DNR has increased its level of review and agrees that additional improvements could be made in the area of subrecipient monitoring.

**Corrective Action:** Employees will again be notified that, if they are unable to enter their own time into the Data Collection and Distribution System (DCDS), the supervisor/manager will be responsible for entering the time, printing the time sheet, and obtaining the employee's signature. If the supervisor is unavailable, the timekeeper will enter the employee's time and

forward a hard copy of the time sheet to the supervisor to obtain the employee's signature. These signed time sheets will be maintained for audit purposes. This procedure will also be shared with all new employees.

Reporting information will be collected in a different manner to allow required reporting.

In this program, there are some situations, such as out-of-State fire assignments and remote field offices, where alternative compensating controls will be implemented. DNR also intends to propose electronic communication alternatives to the Forest Service for situations where direct entry of time by the employee is not feasible.

Documentation requirements will be reviewed with supervisors and staff. The purchase invoices will be matched with the actual inventory received before approving payment.

DNR will implement additional requirements to ensure that all purchases, regardless of nature or size, will be subject to debarment review.

**Anticipated Completion Date:** November 30, 2008

**Responsible Individuals:** Lynne Boyd, Chief, Forest, Mineral and Fire  
Management Division  
Joseph Frick, Chief, Financial Services  
James Wood, Chief, Grants Management

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**Finding Number:** 7510803  
**Finding Title:** Schools and Roads - Grants to States, *CFDA* 10.665

**Management Views:** DNR agrees with Finding 3.a.

With respect to Findings 3.b. and 3.c., DNR has increased its level of review and agrees that additional improvements could be made in the area of subrecipient monitoring.

**Corrective Action:** DNR has already obtained the subrecipient's report on how the \$17,496 was distributed and will continue to follow up with subrecipients who do not submit their reports timely.

**Anticipated Completion Date:** The corrective action has been completed.

**Responsible Individuals:** Amy Henderson, Manager, Financial Services  
Joseph Frick, Chief, Financial Services  
James Wood, Chief, Grants Management

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**Finding Number:** 7510804  
**Finding Title:** Fish and Wildlife Cluster, *CFDA* 15.605 and 15.611

**Management Views:** DNR agrees with Finding 4.a. and will comply with the corresponding recommendation.

DNR agrees with Finding 4.b. that additional controls to deter payments to vendors on the federal suspension and debarment list can be further improved.

**Corrective Action:** Employees will again be notified that, if they are unable to enter their own time into DCDS, the supervisor/manager will be responsible for entering the time, printing the time sheet, and obtaining the employee's signature. If the supervisor is unavailable, the timekeeper will enter the employee's time and forward a hard copy of the time sheet to the supervisor to obtain the employee's signature. These signed time sheets will be maintained for audit purposes. This procedure will also be shared with all new employees.

DNR will implement additional requirements to ensure that all purchases, regardless of nature or size, will be subject to debarment review.

**Anticipated Completion Date:** November 30, 2008

**Responsible Individuals:** Kelley Smith, Chief, Fisheries Division  
Gary Hagler, Chief, Law Enforcement Division  
Joseph Frick, Chief, Financial Services

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**Finding Number:** 7510805

**Finding Title:** State Wildlife Grants, *CFDA* 15.634

**Management Views:** DNR agrees with Finding 5.a. and will comply with the corresponding recommendation.

DNR agrees with Finding 5.b. The employee in question entered her time into DCDS with specific grant project codes. The supervisor had knowledge of her duties and approved her time as well as her coding. While the semi-annual certification form was not prepared for the time period in question, the amount reported was appropriate.

DNR disagrees with Finding 5.c. DNR asserts that the records show third party in-kind contributions that satisfy a cost sharing or matching requirement and are verifiable. The contract in question specifies that the university is allowed to charge for facility and administrative costs. The university has an agreement with its cognizant agency that specifies an indirect rate for these costs. Annually, the university meets with DNR to determine projects to be completed, the amount charged, and the amount of facility and administrative costs that will be waived. The meeting is summarized in a schedule, and the schedule is saved. The budget in the annual work statement

clearly shows that no facility and administrative costs were charged. Since the contract allows for these costs to be charged and the university's cognizant agency has approved the rate, the amount of costs up to that rate should be allowable as waived indirect costs.

DNR agrees that the amount of waived indirect costs would be easier to verify if shown in the project statement each year but does not agree that this should be a questioned cost. Subsequent to the completion of the audit fieldwork, DNR obtained a schedule from the university which details the waived indirect costs for each project and demonstrates that match requirements were met.

DNR agrees with Finding 5.d. that additional controls to deter payments to vendors on the federal suspension and debarment list can be further improved.

**Corrective Action:**

DNR will ensure that all final reports from universities are received and reviewed before final payment is made.

The employee and supervisor are now aware that the extra form is required and have prepared the form semi-annually since the time period in question.

DNR and universities will specify the amounts of waived indirect cost reimbursements in future grant agreement contracts where such costs are used to provide match.

DNR will implement additional requirements to ensure that all purchases, regardless of nature or size, will be subject to debarment review.

**Anticipated Completion Date:** August 30, 2008

**Responsible Individuals:** Ann Leclaire-Mitchell, Manager, Wildlife Division  
Ray Fahlsing, Manager, Wildlife Division  
Joseph Frick, Chief, Financial Services

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**Finding Number:** 7510806

**Finding Title:** Outdoor Recreation - Acquisition, Development and Planning, *CFDA* 15.916

**Management Views:** DNR agrees with Findings 6.a., 6.b., and 6.d. and will comply with the corresponding recommendations.

DNR agrees with Finding 6.c.(1). One project agreement was prepared on an old form that did not have the *CFDA* information on it.

With respect to Finding 6.c.(2), DNR has increased its level of review and agrees that additional improvements could be made in the area of subrecipient monitoring.

**Corrective Action:** Employees will again be notified that, if they are unable to enter their own time into DCDS, the supervisor/manager will be responsible for entering the time, printing the time sheet, and obtaining the employee's signature. If the supervisor is unavailable, the timekeeper will enter the employee's time and forward a hard copy of the time sheet to the supervisor to obtain the employee's signature. These signed time sheets will be maintained for audit purposes. This procedure will also be shared with all new employees.

One of the formulas used to compute the indirect cost rate contained an error, and the formula has already been corrected.

DNR will check all grant agreements before issuance to make sure the correct version of the form has been used.

DNR will save copies of the October reports from the National Park Service to show what projects were outstanding and what ones were completed. DNR will also work on getting the additional records updated.

**Anticipated Completion Date:** November 30, 2008

**Responsible Individuals:** Jim Wood, Chief, Grants Management  
Amy Henderson, Manager, Financial Services

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**Finding Number:** 7510807

**Finding Title:** Boating Safety Financial Assistance, *CFDA 97.012*

**Management Views:** DNR agrees with Findings 7.a. and 7.b.(2). The activities that occurred and the expenditures of \$591,530 would have been allowable if the project had been included in the grant documentation that was submitted. However, there were other sufficient eligible expenditures that occurred within the grant period that could be recognized and accepted by the federal agency as a substitution, thereby nullifying any payback potential.

DNR partially agrees with Findings 7.b.(1), 7.c., and 7.d.(1) in that \$1,470,000 of expenditures did occur outside the grant award period. This grant had annual expenditures that exceeded the amount of the federal award. There were other sufficient eligible expenditures that occurred within the grant period that could be recognized and accepted by the federal agency as a substitution, thereby nullifying any payback potential.

DNR does not agree with the remaining portion of Findings 7.b.(1) and 7.d.(1) in that \$93,493 of expenditures did occur within the grant award period and were allowable.

DNR agrees with Finding 7.b.(3) and will comply with the corresponding recommendation.

DNR agrees with Finding 7.d.(2) in that encumbrances were cleared beyond the 90-day liquidation requirement. However, there were other sufficient eligible expenditures that occurred within the grant period that could be recognized and accepted by the federal agency as a substitution, thereby nullifying any payback potential.

DNR agrees with Finding 7.e. that additional controls to deter payments to vendors on the federal suspension and debarment list can be further improved.

DNR partially agrees with Finding 7.f. in that \$1,470,000 should have been reported on the financial status report as unliquidated. However, there were sufficient other eligible expenditures that could be recognized by the federal agency, thereby nullifying the need to show the \$1,470,000 as unliquidated. DNR does not agree with the remaining portion of the finding. During the grant period, \$93,493 was fully expended and documented, eliminating the need to report these as unliquidated.

With respect to Finding 7.g., DNR has increased its level of review and agrees that additional improvements could be made in the area of subrecipient monitoring.

**Corrective Action:**

DNR has adjusted the default coding in the payroll system for one of the Law Enforcement Division's personnel who was charged 100% to the Boating Safety Financial Assistance Program to accurately reflect the level of effort on the program. The second employee has been instructed to record his time according to the program and corresponding funding source. Beyond that, the remaining financial findings will be addressed by submitting a complete list of eligible projects with the grant application information. In addition, DNR will improve its process to verify the eligibility of expenditures within the grant agreement prior to the drawdown of funds.

DNR will implement additional requirements to ensure that all purchases, regardless of nature or size, will be subject to debarment review.

**Anticipated Completion Date:** November 30, 2008

**Responsible Individuals:**

Eric Sink, Federal Aid Coordinator, Budget and Support Services  
Sharon Schafer, Chief, Budget and Support Services  
James Dubbs, Manager, Law Enforcement Division  
Joseph Frick, Chief, Financial Services  
James Wood, Chief, Grants Management

# GLOSSARY

## Glossary of Acronyms and Terms

BSS	Budget and Support Services.
<i>CFDA</i>	<i>Catalog of Federal Domestic Assistance.</i>
<i>CFR</i>	<i>Code of Federal Regulations.</i>
control deficiency in internal control over federal program compliance	The design or operation of a control that does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect on a timely basis noncompliance with a type of compliance requirement of a federal program.
control deficiency in internal control over financial reporting	The design or operation of a control that does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.
Data Collection and Distribution System (DCDS)	The State's client/server system that records, allocates, and distributes payroll costs within the accounting system for the Michigan Administrative Information System's Human Resource System (MAIN HRS).
DMB	Department of Management and Budget.
DMVA	Department of Military and Veterans Affairs.
DNR	Department of Natural Resources.
financial audit	An audit that is designed to provide reasonable assurance about whether the financial schedules and/or financial statements of an audited entity are presented fairly in all material respects in conformity with the disclosed basis of accounting.

FMFM	Forest, Mineral and Fire Management Division.
GAAP	accounting principles generally accepted in the United States of America.
in-kind contribution	The value of a noncash contribution by a nonfederal third party without charge to the grantee or a cost-type contractor of supplies, equipment, goods, property, and services, directly benefiting and specifically identifiable to a federal program.
internal control	A process, effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance about the achievement of the entity's objectives with regard to the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.
low-risk auditee	As provided for in OMB Circular A-133, an auditee that may qualify for reduced federal audit coverage if it receives an annual Single Audit and it meets other criteria related to prior audit results. In accordance with State statute, this Single Audit was conducted on a biennial basis; consequently, this auditee is not considered a low-risk auditee.
material misstatement	A misstatement in the financial schedules and/or financial statements that causes the schedules and/or statements to not present fairly the financial position or the changes in financial position or cash flows in conformity with the disclosed basis of accounting.
material noncompliance	Violations of laws, regulations, contracts, and grants that could have a direct and material effect on major federal programs or on financial schedule and/or financial statement amounts.

material weakness in internal control over federal program compliance	A significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected.
material weakness in internal control over financial reporting	A significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial schedules and/or financial statements will not be prevented or detected.
MNRTF	Michigan Natural Resources Trust Fund.
OMB	U.S. Office of Management and Budget.
pass-through entity	A nonfederal entity that provides a federal award to a subrecipient to carry out a federal program.
qualified opinion	<p>An auditor's opinion in which the auditor:</p> <ul style="list-style-type: none"> <li>a. Identifies a scope limitation or one or more instances of misstatements that impact the fair presentation of the financial schedules and/or financial statements presenting the basic financial information of the audited agency in conformity with the disclosed basis of accounting or the financial schedules and/or financial statements presenting supplemental financial information in relation to the basic financial schedules and/or financial statements. In issuing an "in relation to" opinion, the auditor has applied auditing procedures to the supplemental financial schedules and/or financial statements to the extent necessary to form an opinion on the basic financial schedules and/or financial statements, but did not apply auditing procedures to the extent that would be necessary to express an opinion on the supplemental financial schedules and/or financial statements taken by themselves; or</li> </ul>

- b. Expresses reservations about the audited agency's compliance, in all material respects, with the cited requirements that are applicable to each major federal program.

questioned costs

A cost that is questioned by the auditor because of an audit finding: (1) which resulted from a violation or possible violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the use of federal funds, including funds used to match federal funds; (2) where the costs, at the time of the audit, are not supported by adequate documentation; or (3) where the costs incurred appear unreasonable and do not reflect the actions a prudent person would take in the circumstances.

SAS 70

Statement on Auditing Standards No. 70, *Service Organizations*, issued by the American Institute of Certified Public Accountants. SAS No. 70 provides guidance for independent auditors who issue reports on the processing of transactions by a service organization for use by other auditors.

significant deficiency in internal control over federal program compliance

A control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected.

significant deficiency in internal control over financial reporting

A control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial schedules and/or

financial statements that is more than inconsequential will not be prevented or detected.

Single Audit

A financial audit, performed in accordance with the Single Audit Act Amendments of 1996, that is designed to meet the needs of all federal grantor agencies and other financial report users. In addition to performing the audit in accordance with the requirements of auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, a Single Audit requires the assessment of compliance with requirements that could have a direct and material effect on a major federal program and the consideration of internal control over compliance in accordance with OMB Circular A-133.

*SOMCAFR*

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subrecipient

A nonfederal entity that expends federal awards received from another nonfederal entity to carry out a federal program.

unqualified opinion

An auditor's opinion in which the auditor states that:

- a. The financial schedules and/or financial statements presenting the basic financial information of the audited agency are fairly presented in conformity with the disclosed basis of accounting; or
- b. The financial schedules and/or financial statements presenting supplemental financial information are fairly stated in relation to the basic financial schedules and/or financial statements. In issuing an "in relation to" opinion, the auditor has applied auditing procedures to the supplemental financial schedules and/or financial statements to the extent necessary to form an opinion

on the basic financial schedules and/or financial statements, but did not apply auditing procedures to the extent that would be necessary to express an opinion on the supplemental financial schedules and/or financial statements taken by themselves; or

- c. The audited agency complied, in all material respects, with the cited requirements that are applicable to each major federal program.









