

PERFORMANCE AUDIT
OF THE

MICHIGAN NATURAL RESOURCES MAGAZINE

DEPARTMENT OF NATURAL RESOURCES

January 2000

EXECUTIVE DIGEST

MICHIGAN NATURAL RESOURCES MAGAZINE

INTRODUCTION

This report, issued in January 2000, contains the results of our performance audit* of the *Michigan Natural Resources Magazine*, Department of Natural Resources (DNR).

AUDIT PURPOSE

This performance audit was conducted as a part of the constitutional responsibility of the Office of the Auditor General. Performance audits are conducted on a priority basis related to the potential for improving effectiveness* and efficiency*.

BACKGROUND

The Magazine was first published as an employee newspaper in 1931. It adopted a magazine format in 1949 and subscriptions were solicited to offset publication costs. Act 133, P.A. 1971, first required the Magazine to become fully self-supporting. In addition to subscription revenue, the Magazine relied on the sale of related merchandise (books, sweatshirts, etc.) to offset its costs. Paid advertising was not permitted in the Magazine while it was published by DNR.

Act 107, P.A. 1979, provided for the creation of a fund for the Magazine. Prior to this, the activities of the Magazine had been contained in the General Fund.

* See glossary at end of report for definition.

In 1990, a report of management options for the Magazine was presented to DNR administration. The report contained five options for the Magazine:

1. Privatization, to include paid advertising (with State editorial and advertising control).
2. Outright sale (with no oversight or control).
3. Continued operations by DNR under a three-year management plan.
4. Establishment of the Magazine as an authority (with more autonomy).
5. Subsidization of Magazine personnel costs with other State funds.

DNR selected the first option (privatization) and in April 1993 accepted the bid of Kolka & Robb, Inc., to publish the Magazine. The bid was \$875,000 plus a percentage of advertising and subscription revenue for a seven-year contract, beginning June 1, 1993. The September/October 1993 issue of the Magazine was the first published by Kolka & Robb, Inc.

In January 1996, DNR approved a retroactive change in the contract that excused Kolka & Robb, Inc., from making 14 consecutive payments to the State from May 1995 through June 1996. Also, the contract was extended 3 1/2 years (from June 1, 2000 through December 31, 2003) while providing for the same total revenue to the State (\$875,000).

On July 9, 1999, DNR entered into a release and settlement agreement with the publisher to cease publication of the Magazine.

AUDIT OBJECTIVES
AND CONCLUSIONS

Audit Objective: To assess the economic viability of the Magazine.

Conclusion: We concluded that the economic viability of the Magazine is doubtful.

Audit Objective: To assess the effectiveness of DNR's administration of the Magazine contract.

Conclusion: We concluded that DNR's administration of the Magazine contract, over its duration, did not achieve the intended results. Our assessment disclosed a reportable condition* regarding contract fulfillment (Finding 1).

AUDIT SCOPE AND
METHODOLOGY

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

Our audit procedures included examinations of DNR's records and activities for the period June 1970 through April 1999.

We studied legislation, management plans, DNR correspondence, DNR internal audit reports and data, the Magazine's contract and contract change notices, and the

* See glossary at end of report for definition.

Magazine's financial and subscription data. We interviewed DNR staff as necessary.

AGENCY RESPONSES

Our audit report includes 1 finding and corresponding recommendation. DNR agreed with the finding and recommendation.

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

Dear Mr. Charters and Mr. Cool:

This is our report on the performance audit of the *Michigan Natural Resources Magazine*, Department of Natural Resources.

This report contains our executive digest; description of program; audit objectives, scope, and methodology and agency responses; comments, finding, recommendation, and agency preliminary response; various exhibits, presented as supplemental information; and a glossary of acronyms and terms.

Our comments, finding, and recommendation are organized by audit objective. The agency preliminary response was taken from the agency's response subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

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

AUDITOR GENERAL

This page left intentionally blank.

TABLE OF CONTENTS

MICHIGAN NATURAL RESOURCES MAGAZINE DEPARTMENT OF NATURAL RESOURCES

INTRODUCTION

	<u>Page</u>
Executive Digest	1
Report Letter	5
Description of Program	8
Audit Objectives, Scope, and Methodology and Agency Responses	10

COMMENTS, FINDING, RECOMMENDATION, AND AGENCY PRELIMINARY RESPONSE

Economic Viability	11
Contract Administration	12
1. Contract Fulfillment	13

SUPPLEMENTAL INFORMATION

Exhibit 1 - Net Income (Loss) and Retained Earnings	16
Exhibit 2 - Financial Trends	17
Exhibit 3 - Average Subscriptions Per Issue by Fiscal Year	18

GLOSSARY

Glossary of Acronyms and Terms	19
--------------------------------	----

Description of Program

The *Michigan Natural Resources Magazine*, Department of Natural Resources (DNR), was first published as an employee newspaper in 1931. It adopted a magazine format in 1949 and subscriptions were solicited to offset publication costs. The Magazine was published bimonthly.

In Act 98, P.A. 1970, the Legislature made its intent known that all future publication costs should be financed from the sale of the Magazine. Act 133, P.A. 1971, first required the Magazine to become fully self-supporting. In addition to subscription revenue, the Magazine relied on the sale of related merchandise (books, sweatshirts, etc.) to offset its costs. Paid advertising was not permitted in the Magazine.

Act 107, P.A. 1979, provided for the creation of a fund for the Magazine. The Department of Natural Resources Magazine Fund (an enterprise fund) was established to account for the administration of the publication of the Magazine, publications, and related materials. Prior to this, the activities of the Magazine had been contained in the General Fund.

In 1990, a report of management options for the Magazine was presented to DNR administration. The report contained five options for the Magazine:

1. Privatization (with State editorial and advertising control).
2. Outright sale (with no oversight or control).
3. Continued operations by DNR under a three-year management plan.
4. Establishment of the Magazine as an authority (with more autonomy).
5. Subsidization of Magazine personnel costs with other State funds.

DNR selected the first option (privatization) and in April 1993 accepted the bid of Kolka & Robb, Inc., to publish the Magazine. The bid was \$875,000 (\$10,416 per month) plus a percentage of advertising and subscription revenue for a seven-year contract

beginning June 1, 1993. The September/October 1993 issue of the Magazine was the first published by Kolka & Robb, Inc.

In January 1996, DNR approved a retroactive change in the contract that excused Kolka & Robb, Inc., from making 14 consecutive payments to the State from May 1995 through June 1996. Also, beginning in July 1996, the publisher's monthly payment was reduced to \$5,000 until July 1997, when it would increase to \$8,445 per month. Further, the contract was extended 3 1/2 years (from June 1, 2000 through December 31, 2003) while providing for the same total revenue to the State (\$875,000).

The publisher stopped making the required payments to the State as of December 1998. DNR issued three vendor performance complaints from November 1998 through March 1999 and issued a final deficiency notice on March 17, 1999 detailing several areas where the publisher failed to fulfill contract requirements. On July 9, 1999, DNR entered into a release and settlement agreement with the publisher. Key portions of the agreement are:

1. The total amount to be paid to the State by the publisher is \$354,158, instead of the \$875,000 provided for in the original contract.
2. The publisher will no longer publish the Magazine.
3. DNR will not publish or distribute the Magazine for a period of 5 years.

Audit Objectives, Scope, and Methodology and Agency Responses

Audit Objectives

Our performance audit of the *Michigan Natural Resources Magazine*, Department of Natural Resources (DNR), had the following objectives:

1. To assess the economic viability of the Magazine.
2. To assess the effectiveness of DNR's administration of the Magazine contract.

Audit Scope

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

Audit Methodology

Our audit procedures were performed between February and April 1999 and included examinations of DNR's records and activities for the period June 1970 through April 1999.

We studied legislation, management plans, DNR correspondence, DNR internal audit reports and data, the Magazine's contract and contract change notices, and the Magazine's financial and subscription data. We interviewed DNR staff as necessary.

Agency Responses

Our audit report includes 1 finding and corresponding recommendation. DNR agreed with the finding and recommendation.

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

COMMENTS, FINDING, RECOMMENDATION, AND AGENCY PRELIMINARY RESPONSE

ECONOMIC VIABILITY

COMMENT

Audit Objective: To assess the economic viability of the *Michigan Natural Resources Magazine*.

Conclusion: We concluded that the economic viability of the Magazine is doubtful, based on these conditions:

- a. The Department of Natural Resources (DNR) has incurred losses in 16 (59%) of the last 27 fiscal years (see Exhibits 1 and 2, presented as supplemental information). The Magazine's retained earnings have eroded from a negative balance of nearly \$50,000 in fiscal year 1970-71 to a negative balance of \$1,449,000 in fiscal year 1996-97. As of October 1, 1997, the General Fund made an equity transfer of \$1,449,000 to the Department of Natural Resources Magazine Fund to eliminate its deficit and to close the Fund.

Also, the Department of Treasury did not charge the Fund any interest in two (1994-95 and 1996-97) of the four fiscal years that the Magazine was published under contract but still accounted for in its own fund. If interest had been charged, the Fund's negative retained earnings would have increased by approximately \$100,000.

In addition, the Magazine underreported its operating expense in fiscal year 1995-96. Expenses for the editor were not charged to the Fund, although the editor continued working on the Magazine. If the editor's wages had been charged to the Magazine, the Fund's negative retained earnings would have increased by approximately \$50,000.

- b. DNR contracted out the Magazine's operations to a private publisher in 1993 in an effort to make the Magazine self-supporting and to eventually eliminate the

negative retained earnings balance. The original contract called for the State to receive a total of \$875,000 in equal payments over 7 years. However, just over a year into the contract, the publisher began missing payments and, ultimately, missed 14 continuous months' worth of payments (\$146,000) to the State. DNR renegotiated the contract, extending the contract 3 1/2 years while maintaining the original total contract amount of \$875,000, thus reducing the State's revenue per year.

As a result of the renegotiation of the contract's financial terms, the State received \$242,000 from the contractor from June 1993 through September 1997 instead of \$542,000 as originally provided by the contract. Consequently, DNR was not able to lessen its negative retained earnings balance through this contract.

- c. Subscriptions to the Magazine and newsstand sales have generally declined over the last 23 years from 182,573 copies in fiscal year 1976-77 to 41,571 copies in fiscal year 1998-99 (see Exhibit 3, presented as supplemental information). The low level of subscriptions and corresponding revenue, combined with the fixed costs of publishing the Magazine, have contributed to the losses incurred by the Magazine and the resulting negative retained earnings balance.

Overall, the revenue generated from the Magazine both when it was published by DNR and from the Magazine contract has not been sufficient to support the Magazine operation.

CONTRACT ADMINISTRATION

COMMENT

Audit Objective: To assess the effectiveness of DNR's administration of the Magazine contract.

Conclusion: We concluded that DNR's administration of the Magazine contract, over its duration, did not achieve the intended results. Our assessment disclosed a reportable condition regarding contract fulfillment.

FINDING

1. Contract Fulfillment

DNR did not ensure that the contracted publisher fulfilled all contract obligations. We noted two areas in which significant obligations were not fulfilled:

- a. The original contract, issued as the result of a competitive bidding process, required the contracted publisher to publish the Magazine for 7 years (June 1, 1993 through June 1, 2000) and to pay the State \$875,000 in equal installments over those 7 years.

Just over a year into the contract, the publisher began missing payments. Between May 1995 and June 1996, the publisher missed 14 consecutive months of payments totaling \$146,000. Then DNR entered into an agreement in January 1996, extending the contract an additional 3 1/2 years (through December 31, 2003), while maintaining the original total contract amount of \$875,000, thus reducing the State's revenue per year from \$125,000 to \$101,340.

In the fall of 1998, following other difficulties with the contract, DNR held meetings with the contracted publisher to explore options for continuing this relationship and to provide contract direction, goals, and expectations. The contracted publisher was asked to submit proposals for how it intended to comply with contract provisions. However, the proposal submitted by the contracted publisher in February 1999 was considered unacceptable by DNR because of the significant changes requested to relieve the publisher of its financial burdens.

Shortly thereafter, DNR began negotiations with the contracted publisher to enter into a release and settlement agreement. This agreement was made effective July 9, 1999. Under this agreement, DNR agreed to accept a total payment amount of \$354,158 instead of the original contract amount of \$875,000. DNR also agreed that the contracted publisher would no longer publish the Magazine. DNR further agreed that it would not publish or distribute the Magazine for a period of 5 years.

- b. The original contract also required the contracted publisher to obtain a surety bond, certificate of deposit, or letter of credit to cover the amount of outstanding subscription liability throughout the contract period. In June 1993,

DNR paid the contracted publisher \$677,265 in cash for the unfulfilled subscription liability that the publisher assumed under the contract. DNR did not obtain surety coverage from June 1, 1993, when the contract began, through February 1994. In February 1994, DNR agreed to a contract change to reduce the level of surety coverage required to \$200,000 and obtained a certificate of deposit from the publisher.

In the release and settlement agreement, DNR agreed to release the certificate of deposit to the publisher immediately upon execution of the agreement, which was July 9, 1999. The release and settlement agreement also provided for the publisher to provide subscribers, at the subscribers' option, an alternate publication or a refund for the unfulfilled subscription liability. As of November 15, 1999, subscribers were notified of the alternative publication.

Because DNR accepted less surety coverage than required by the original contract and released the surety coverage on hand before the publisher resolved the unfulfilled subscription liability, Magazine subscribers had less assurance that their subscriptions would be fulfilled.

RECOMMENDATION

We recommend that DNR ensure that its contractors fulfill all contractual obligations.

AGENCY PRELIMINARY RESPONSE

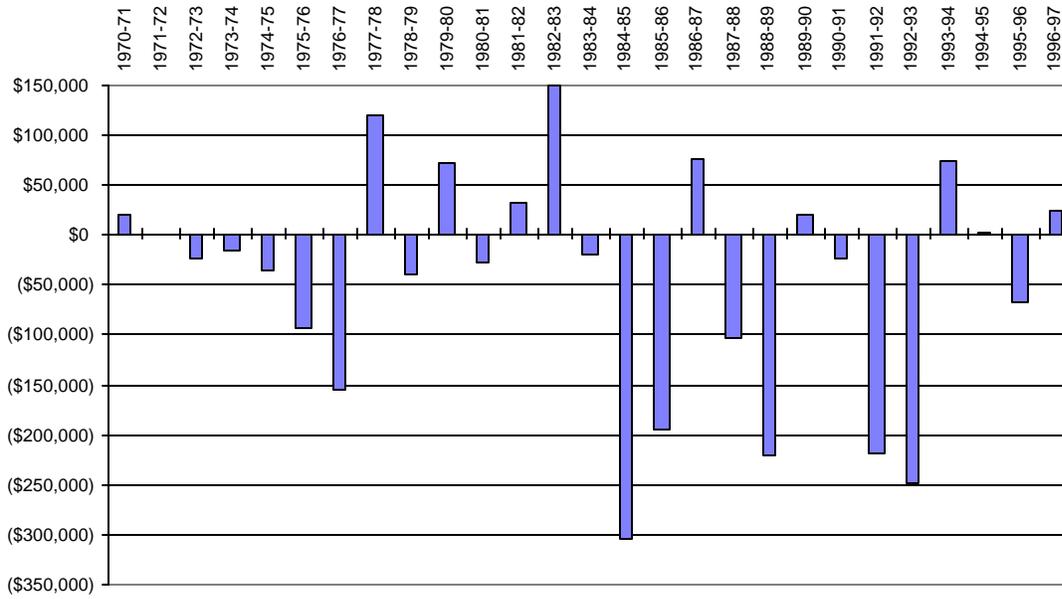
DNR agrees. DNR took all available steps to require contractor compliance with the contract. When the contractor failed to comply, DNR took the only action available, contract cancellation.

SUPPLEMENTAL INFORMATION

MICHIGAN NATURAL RESOURCES MAGAZINE

Net Income (Loss)

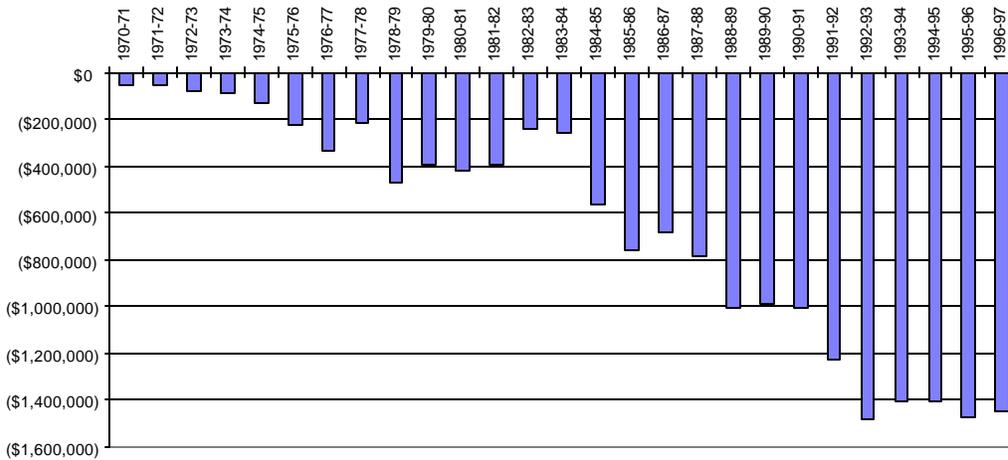
Fiscal Years 1970-71 through 1996-97



DEPARTMENT OF NATURAL RESOURCES MAGAZINE FUND

Retained Earnings

Fiscal Years 1970-71 through 1996-97



Sources of data: *State of Michigan Comprehensive Annual Financial Reports* (fiscal years 1979-80 through 1996-97) and unaudited internal Department of Natural Resources' reports (fiscal years 1970-71 through 1978-79).

MICHIGAN NATURAL RESOURCES MAGAZINE

Financial Trends

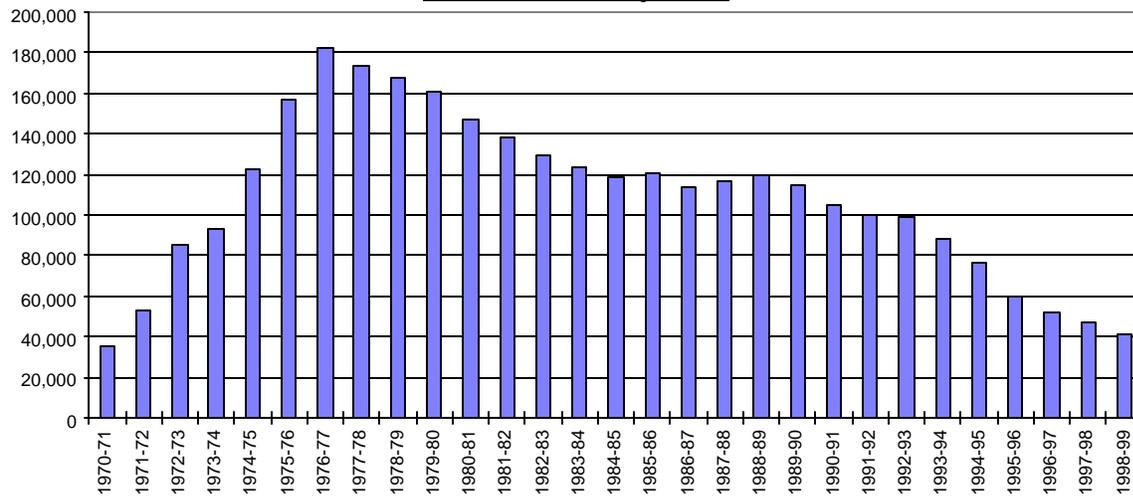
Fiscal Years 1970-71 through 1996-97

Fiscal Year	Net Income (Loss)	Retained Earnings Balance at End of Fiscal Year
1970-71	\$ 20,155	\$ (49,881)
1971-72	\$ 44	\$ (49,837)
1972-73	\$ (24,053)	\$ (73,890)
1973-74	\$ (15,989)	\$ (89,879)
1974-75	\$ (36,699)	\$ (126,578)
1975-76	\$ (93,024)	\$ (219,602)
1976-77	\$ (153,513)	\$ (335,563)
1977-78	\$ 117,982	\$ (217,581)
1978-79	\$ (38,878)	\$ (467,266)
1979-80	\$ 72,000	\$ (394,000)
1980-81	\$ (28,000)	\$ (423,000)
1981-82	\$ 32,000	\$ (390,000)
1982-83	\$ 149,000	\$ (241,000)
1983-84	\$ (19,000)	\$ (261,000)
1984-85	\$ (303,000)	\$ (564,000)
1985-86	\$ (196,000)	\$ (760,000)
1986-87	\$ 76,000	\$ (684,000)
1987-88	\$ (102,000)	\$ (787,000)
1988-89	\$ (221,000)	\$ (1,008,000)
1989-90	\$ 21,000	\$ (986,000)
1990-91	\$ (24,000)	\$ (1,011,000)
1991-92	\$ (219,000)	\$ (1,231,000)
1992-93	\$ (248,000)	\$ (1,480,000)
1993-94	\$ 73,000	\$ (1,407,000)
1994-95	\$ 2,000	\$ (1,405,000)
1995-96	\$ (67,000)	\$ (1,472,000)
1996-97	\$ 23,000	\$ (1,449,000)

Beginning October 1, 1997, the activities of the Magazine were accounted for in the General Fund. Accordingly, an equity transfer was made from the General Fund to eliminate the deficit.

Sources of data: *State of Michigan Comprehensive Annual Financial Reports* (fiscal years 1979-80 through 1996-97) and unaudited internal Department of Natural Resources' reports (fiscal years 1970-71 through 1978-79).

MICHIGAN NATURAL RESOURCES MAGAZINE
Average Subscriptions Per Issue by Fiscal Year
Fiscal Years 1970-71 through 1998-99



Fiscal Year	Average Magazine Subscription and Newsstand Sales Per Issue	Fiscal Year	Average Magazine Subscription and Newsstand Sales Per Issue
1970-71	34,966	1984-85	118,769
1971-72	52,549	1985-86	120,194
1972-73	85,528	1986-87	113,380
1973-74	92,644	1987-88	116,783
1974-75	122,903	1988-89	119,932
1975-76	156,849	1989-90	115,067
1976-77	182,573 (a)	1990-91	104,657
1977-78	173,165	1991-92	100,000
1978-79	167,670	1992-93	98,800
1979-80	161,200	1993-94	88,190 (b)
1980-81	146,715	1994-95	76,671
1981-82	137,885	1995-96	59,603
1982-83	129,901	1996-97	52,365
1983-84	123,312	1997-98	46,527
		1998-99	41,571 (c)

(a) Magazine first issued to newsstands.

(b) First Kolka & Robb, Inc., issue in September/October 1993.

(c) For 4 published issues.

Source of data: Department of Natural Resources' subscription records

Glossary of Acronyms and Terms

DNR	Department of Natural Resources.
effectiveness	Program success in achieving mission and goals.
efficiency	Achieving the most outputs and outcomes practical for the amount of resources applied or minimizing the amount of resources required to attain a certain level of outputs or outcomes.
outcomes	The actual impacts of the program. Outcomes should positively impact the purpose for which the program was established.
outputs	The products or services produced by the program. The program assumes that producing its outputs will result in favorable program outcomes.
performance audit	An economy and efficiency audit or a program audit that is designed to provide an independent assessment of the performance of a governmental entity, program, activity, or function to improve public accountability and to facilitate decision making by parties responsible for overseeing or initiating corrective action.
reportable condition	A matter coming to the auditor's attention that, in his/her judgment, should be communicated because it represents either an opportunity for improvement or a significant deficiency in management's ability to operate a program in an effective and efficient manner.