

STATE OF LOUISIANA LEGISLATIVE AUDITOR

Department of Natural Resources
State of Louisiana
Baton Rouge, Louisiana

December 18, 1997



Financial and Compliance Audit Division

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Legislative Auditor*

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**DEPARTMENT OF NATURAL RESOURCES
STATE OF LOUISIANA
Baton Rouge, Louisiana**

**Management Letter
Dated December 4, 1997**

Under the provisions of state law, this report is a public document. A copy of this report has been submitted to the Governor, to the Attorney General, and to other public officials as required by state law. A copy of this report has been made available for public inspection at the Baton Rouge office of the Legislative Auditor.

December 10, 1997



STATE OF LOUISIANA, CPA, CMA
LEGISLATIVE AUDITOR

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December 4, 1997

DEPARTMENT OF NATURAL RESOURCES
STATE OF LOUISIANA
Baton Rouge, Louisiana

As part of our audit of the State of Louisiana's financial statements for the year ended June 30, 1997, we conducted certain procedures at the Department of Natural Resources. Our procedures included: (1) a review of certain department internal control structures; (2) tests of financial transactions; (3) tests of adherence to applicable laws, regulations, policies, and procedures governing financial activities; and (4) a review of compliance with prior year report recommendations.

The June 30, 1997, Annual Fiscal Report of the Department of Natural Resources was not audited or reviewed by us, and, accordingly, we do not express an opinion or any other form of assurance on that report. The department's accounts are an integral part of the State of Louisiana's financial statements, upon which the Louisiana Legislative Auditor expresses an opinion.

Our procedures included interviews with management personnel and selected department personnel. We also evaluated selected documents, files, reports, systems, procedures, and policies as we considered necessary. After analyzing the data, we developed recommendations for improvement. We then discussed our findings and recommendations with appropriate management personnel before submitting this written report.

In our prior management letter dated November 12, 1996, to the Department of Natural Resources, we reported a finding relating to incorrect royalty allocations. This finding has been resolved by management.

Based upon the application of the procedures referred to previously, all significant findings are included in this report for management's consideration.

Inaccurate Reporting of Mineral Income

The Department of Natural Resources (DNR) failed to properly report major state revenues (mineral income) for the fiscal years ended June 30, 1996 and 1997. Title 4, Chapter 31 of the Louisiana Administrative Code [Policy and Procedures Memorandum (PPM) No. 66] and written instructions issued by the Division of Administration, Office of Statewide Reporting and Accounting Policy, established criteria and procedures to assist agencies in preparing accurate annual financial statements. PPM No. 66 specifies that revenue should be recognized in the fiscal year in which economic

DEPARTMENT OF NATURAL RESOURCES
STATE OF LOUISIANA
Management Letter, Dated December 4, 1997
Page 2

activity generates the revenue. In addition, an adequate system of internal control should include adequate supervision and review to ensure that errors in financial reporting are detected and corrected in a timely manner. In our review of mineral income, we noted the following errors:

- Approximately \$14.6 million was incorrectly classified to fiscal year 1997 instead of 1996.
- The department used an incorrect allocation base to allocate the mineral income receivable between the individual funds for fiscal year 1996.
- The department double-counted revenues of approximately \$4.3 million when reporting revenues for fiscal year 1996.

Collectively, these errors resulted in an understatement and overstatement of revenues for fiscal years 1996 and 1997, respectively, of approximately \$10.3 million.

- The department incorrectly classified \$2.6 million in mineral income to the state General Fund when it was actually parish road royalty fund monies due to the various parishes within the state for fiscal year 1996.
- The department incorrectly classified approximately \$2.2 million to fiscal year 1997 instead of 1996; however, we brought this error to the attention of DNR management and it was corrected before the submission of its 1997 Annual Fiscal Report.

These errors were caused by a lack of communication between divisions within the department and an overall lack of understanding of the financial reporting requirements relating to major state revenues.

The department should develop and implement review procedures to ensure that major state revenues are correctly classified between funds and between fiscal years. In a letter dated November 7, 1997, Mr. Robert D. Harper, Undersecretary, concurred with the finding and outlined the steps for corrective action.

Timely Processing of Royalties

The Department of Natural Resources failed to timely identify royalty receipts to specific leases over the past 18 years and failed to timely remit the required portion of these royalties to the appropriate parishes. Good internal controls should ensure that all royalties received are processed timely, and all obligations due are paid in a timely manner. Louisiana Revised Statute (R.S.) 30:145 states that one-third of all royalties accruing to the state is to be remitted to the parish where the production occurred.

DEPARTMENT OF NATURAL RESOURCES
STATE OF LOUISIANA
Management Letter, Dated December 4, 1997
Page 3

The department received approximately \$13 million in royalties between 1979 and 1997, which remained unallocated by the Louisiana Mineral Income System (LDMIS), as of August 15, 1997. Consequently, approximately \$1.3 million of these royalties have not been identified and paid to various parishes within the state as required.

These royalties have not been allocated by LDMIS because they were received without adequate supporting documentation for the department to determine what the royalty is for and where the production occurred. Timely follow-up and processing by DNR has caused these funds to remain unallocated in the state treasury.

The department should investigate all unallocated royalties that have accumulated over the past 18 years to identify the parish where the production occurred so that the required payments can be properly remitted to the parish. In addition, the department should implement new procedures for a timely follow-up of incomplete documentation accompanying royalty receipts to ensure timely processing of the related parish payments. In a letter dated November 5, 1997, Mr. Robert D. Hager, Undersecretary, concurred with the finding and outlined the steps for corrective action.

Ineffective Internal Audit Function

The Department of Natural Resources does not have an effective internal audit function. This function should provide management with assurance that assets of the department are properly safeguarded, internal controls are established and operating in accordance with applicable laws and regulations, and procedures are sufficient to prevent or detect errors and/or fraud in a timely manner. We noted the following weaknesses in the internal audit structure and function:

1. The internal auditor did not prepare an overall audit plan.
2. The internal auditor's files lacked formal audit plans, audit programs, and working papers.

Considering the department's assets of approximately \$86 million and revenues of approximately \$419 million (including major state revenues), an effective internal audit function is needed to ensure the safeguarding of assets and compliance with state laws and departmental regulations.

The department should improve the effectiveness of its internal audit function by ensuring that its audits are properly planned, performed, and documented. In a letter dated October 13, 1997, Mr. Robert D. Hager, Undersecretary, concurred with the finding and outlined the steps for corrective action.

DEPARTMENT OF NATURAL RESOURCES
STATE OF LOUISIANA
Management Letter, Dated December 4, 1967
Page 4

**Electronic Data Processing
User Control Weaknesses**

The Department of Natural Resources has not established adequate internal controls over the Advanced Governmental Purchasing System (AGPS) and the Government Financial System (GFS). Good user controls require that written procedures be established for the issuance and deletion of user identification codes (user IDs), that individuals be permitted access only to the data files and programs necessary to perform their duties, and that duties be properly segregated. During our review of the department's EDP user controls, the following weaknesses were observed:

1. There are no written procedures for the issuance of user IDs or the deletion of user IDs once an employee terminates employment with the department.
2. Access to AGPS was not removed timely for three employees who terminated employment. We noted that access for these employees was not deleted until three to seven months after termination.
3. Five employees have access to both enter new vendors in AGPS and to approve vendor payments.

Management has not emphasized the importance of access security to AGPS and GFS. Failure to establish adequate EDP user controls increases the risk that errors and/or fraud could occur and not be detected in a timely manner.

The department should establish written procedures for the issuance and deletion of user IDs, should delete terminated employees' user IDs immediately following termination, and should ensure that employees do not have access to perform incompatible duties. In a letter dated October 15, 1967, Mr. Robert D. Harper, Undersecretary, concurred with the finding and outlined the steps for corrective action.

The recommendations in this report represent, in our judgment, those most likely to bring about beneficial improvements to the operations of the department. The varying nature of the recommendations, their implementation costs, and their potential impact on operations of the department should be considered in reaching decisions on courses of action. The findings related to the department's compliance with applicable laws and regulations should be addressed immediately by management.

DEPARTMENT OF NATURAL RESOURCES

STATE OF LOUISIANA

Management Letter, Dated December 4, 1997

Page 2

This report is intended for the information and use of the department and its management. By provisions of state law, this report is a public document, and it has been distributed to appropriate public officials.

Respectfully submitted,



Daniel G. Kyle, CPA, CFE
Legislative Auditor

BGD:BAJ/dl

2000