



A REPORT
TO THE
MONTANA
LEGISLATURE

FINANCIAL-COMPLIANCE AUDIT

*Department of
Natural Resources and
Conservation*

*For the Two Fiscal Years Ended
June 30, 2018*

NOVEMBER 2018

LEGISLATIVE AUDIT
DIVISION

18-17

FINANCIAL-COMPLIANCE AUDITS

LEGISLATIVE AUDIT COMMITTEE

REPRESENTATIVES

KIM ABBOTT

Kim.Abbott@mtleg.gov

DAN BARTEL

Danbartel2@gmail.com

RANDY BRODEHL

Randybrodehl57@gmail.com

TOM BURNETT, VICE CHAIR

Burnett.tom@gmail.com

VIRGINIA COURT

virginiacourt@yahoo.com

DENISE HAYMAN

Denise.Hayman@mtleg.gov

SENATORS

DEE BROWN

senatordee@yahoo.com

TERRY GAUTHIER

Mrmac570@me.com

BOB KEENAN

Bob.Keenan@mtleg.gov

MARGARET MACDONALD

MARGIE.MACDONALD@MTLEG.GOV

MARY McNALLY, CHAIR

McNally4MTLeg@gmail.com

GENE VUCKOVICH

Gene.Vuckovich@mtleg.gov

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Financial-compliance audits are conducted by the Legislative Audit Division to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States Government Accountability Office. Financial-compliance audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

The Single Audit Act Amendments of 1996 and the Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards require the auditor to issue certain financial, internal control, and compliance reports in addition to those reports required by *Government Auditing Standards*. This individual agency audit report is not intended to comply with these reporting requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 2017, was issued March 23, 2018. The Single Audit Report for the two fiscal years ended June 30, 2019, will be issued by March 31, 2020.

AUDIT STAFF

JESSICA CURTIS
NATALIE H. GIBSON

JENNIFER ERDAHL
MARY V. YUREWITCH

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LEGISLATIVE AUDIT DIVISION

Angus Maciver, Legislative Auditor
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors
Cindy Jorgenson
Joe Murray

November 2018

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial-compliance audit report on the Department of Natural Resources and Conservation for the two fiscal years ended June 30, 2018. Included in this report are recommendations related to internal controls over accounting entries and procards, and compliance with state laws related to reporting for the Flathead Basin Commission. The fiscal year 2017 financial schedules have opinion qualifications related to incorrectly recording investment activity as prior year activity.

During the audit we focused on Transfers-In and Transfers-Out in the Land Grant Trusts and Other Services activity. Other Services expenditure activity at the department was larger than in the prior audit due to the large fire season in fiscal year 2018. We also audited activity in the State Revolving Fund Programs, Natural Resources Grants, Transfers-In and Transfers-Out of the Fire Suppression Fund, as well as testing compliance with state laws and policies.

The department's written response to the audit recommendations is included in the audit report at page C-1. We thank the director and his staff for their cooperation and assistance throughout the audit.

Respectfully submitted,

/s/ Angus Maciver

Angus Maciver
Legislative Auditor

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ELECTED, APPOINTED, AND ADMINISTRATIVE OFFICIALS

Administrative Officials

John E. Tubbs, Director
 Kerry Davant, Deputy Director
 Danna Jackson, Chief Legal Counsel
 Mark Bostrom, Administrator, Conservation and Resource Development
 Division
 Sonya Germann, Administrator, Forestry Division
 Jim Halvorson, Administrator, Oil and Gas Conservation Division
 Jan Langel, Administrator, Water Resources Division
 Shawn Thomas, Administrator, Trust Land Management Division
 Tricia Greiberis, Chief Financial Officer

State Board of Land Commissioners

Steve Bullock, Governor
 Matthew Rosendale, Commissioner of Securities and Insurance
 Corey Stapleton, Secretary of State
 Elsie Arntzen, Superintendent of Public Instruction
 Tim Fox, Attorney General

Boards, Commissions & Committees

Board of Oil and Gas Conservation Commission
 Board of Water Well Contractors
 Flathead Basin Commission
 Montana Grass Conservation Commission
 Montana Invasive Species Council
 Montana Sage Grouse Oversight Team
 Resource Conservation Advisory Council
 Rangeland Resources Committee
 Drought Advisory Committee and Associated Watershed Advisory Councils
 St. Mary's Rehabilitation Working Group
 Forest Stewardship Steering Committee
 Tongue River Advisory Committee
 Upper Columbia Conservation Commission


 MONTANA LEGISLATIVE AUDIT DIVISION

FINANCIAL-COMPLIANCE AUDIT

Department of Natural Resources and Conservation

For the Two Fiscal Years Ended June 30, 2018

NOVEMBER 2018

18-17

REPORT SUMMARY

The Department of Natural Resources and Conservation managed annual state fire suppression costs of approximately \$19.2 million in fiscal year 2017 and approximately \$65.3 million in fiscal year 2018. The department had approximately \$36.7 million in accounts receivable from federal agencies at June 30, 2018, for firefighting costs incurred in fiscal year 2018 and previous years. Due to the complexity of fire funding, this accounts receivable includes costs related to fires from 2012 to present. The Fire Suppression account in the State Special Revenue Fund had a fund equity of approximately \$8.5 million at June 30, 2018, which is available for funding future fires.

Context

During the audit we focused on Personal Services expenses, land grant revenues, Transfers-In and Transfers-Out in the land grant trusts, activity in the State Revolving Fund Programs, and Other Services Expenses. Other Services activity includes items like consulting and professional services, accrued fire suppression services, and private equipment drivers. The activity was larger than in the prior audit due to the large fire season in fiscal year 2018. Annual state fire suppression costs were \$19.2 million in fiscal year 2017 and \$65.3 million in fiscal year 2018. We tested receivables and payables related to the large fiscal year 2018 fire season and Transfers-In and Transfers-Out of the fire suppression account. We also tested laws related to the Water Resources Division, Board of Oil and Gas Conservation, and state lands.

For fiscal years 2017 and 2018, the Department of Natural Resources and Conservation (department) generated distributable revenue through its management of state lands for 14 separate land trusts. The accounting error and qualified opinion over the schedules in fiscal year 2017 discussed in this audit report are not related to the distributable revenue in the Permanent Trust Fund. The error is related to a change in market value of investments recorded

only in the trust land funds. In addition to investment earnings, distributable revenue is generated from several land use sources with rentals, leases and royalties being the primary source; it decreased from \$59.5 million in fiscal year 2016 to \$48.4 million in fiscal year 2017. The same category of revenue increased to \$50.7 million in fiscal year 2018. Rentals, leases, and royalties includes hydro electric revenue, which decreased in fiscal year 2017 because the revenue is under protest. The Hydropower Site Lease between the department and Avista allows rental payments under protest. Avista established a joint escrow account with the state of Montana at U.S. Bank and deposited \$9.5 million, which represents their 2017 and 2018 lease payments, into the account. In addition, grazing rentals, also decreased in both fiscal years 2017 and 2018 based on the decline of cattle prices. See table below.

State Land Revenue			
	FY16	FY17	FY18
Rentals, Leases, and Royalties in the Permanent Fund	\$59.5 million	\$48.4 million	\$50.7 million
Investment Earnings	\$45.0 million	\$6.3 million	\$2.1 million

Source: Compiled by the Legislative Audit Division.

(continued on back)

Results

The current report contains recommendations related to:

- ◆ Improving internal controls over land grant accounting entries at fiscal year-end.
- ◆ Compliance related to the Flathead Basin Commission.
- ◆ Improving controls over temporary increases in limits for employee procards.

The report also includes repeat recommendations related to:

- ◆ Entry and approval of accounting entries by the same person.
- ◆ Improving controls over the documentation of employee receipt of gift cards given as awards.

In addition, there is a modified opinion on the financial schedules for fiscal year 2017, meaning the reader should use caution when using these financial schedules.

Recommendation Concurrence	
Concur	5
Partially Concur	0
Do Not Concur	0
Source: Agency audit response included in final report.	

For a complete copy of the report (18-17) or for further information, contact the Legislative Audit Division at 406-444-3122; e-mail to lad@mt.gov; or check the web site at <http://leg.mt.gov/audit>
Report Fraud, Waste, and Abuse to the Legislative Auditor's FRAUD HOTLINE
Call toll-free 1-800-222-4446, or e-mail lad@mt.gov.

Chapter I – Introduction

Introduction

We performed a financial-compliance audit of the Department of Natural Resources and Conservation (department) for the two fiscal years ended June 30, 2018.

The objectives of this audit were to:

1. Determine whether the department complied with selected state and federal laws and regulations.
2. Obtain an understanding of the department's internal controls to the extent necessary to support our audit of the department's financial schedules, and if appropriate, make recommendations for improvement in management and internal controls of the department.
3. Determine whether the department's financial schedules present fairly the results of operations and changes in fund equity and property held in trust for each of the two fiscal years ended June 30, 2018.
4. Determine the implementation status of prior audit recommendations.

During the audit we focused on personal services expenses, land grant revenues, transfers-in and transfers-out in the land grant trusts, activity in the State Revolving Fund programs, and other services expenditures. Other services activity includes items like consulting and professional services, accrued fire suppression services, and private equipment drivers. The activity was larger than in the prior audit due to the large fire season in fiscal year 2018. Annual state fire suppression costs were \$19.2 million in fiscal year 2017 and \$65.3 million in fiscal year 2018. We tested receivables and payables related to the large fiscal year 2018 fire season and transfers in and out of the fire suppression account. We tested laws related to the Water Resources Division, Board of Oil and Gas Conservation, and state lands along with following up on hotline calls.

We evaluated fees and charges for services in the Internal Service Fund as required by §17-8-101(6), MCA. The internal service fund accounts for the financing of goods or services provided by one department to other departments of state government or to other governmental entities on a cost-reimbursed basis. The department Internal Service Fund contains the Forestry Division's Air Operations Program. The Air Operations Program maintains and operates aircraft to aid in fire suppression. We considered fees commensurate with costs if working capital was positive and did not exceed 60 days of expenditure activity for the fund. State accounting policy defines working capital as the amount of cash that would remain if all the current assets were converted, and all the current liabilities paid, at their book value. We found the fees

and charges were commensurate with costs, and fund equity was reasonable for the Air Operations Program in fiscal years 2017 and 2018.

Background Information

The department's mission is to help ensure that Montana's land and water resources provide benefits for present and future generations.

Department Organization

The State Board of Land Commissioners, comprised of the Governor, Commissioner of Securities and Insurance, Attorney General, Superintendent of Public Instruction, and Secretary of State exercises the general authority, direction, and control over the care, management, and disposition of state lands under its administration. The department's director is the chief administrative officer of the board.

The following descriptions of the department's six divisions include the number of budgeted full-time equivalent (FTE) positions in fiscal year 2018.

Director's Office (57.00 FTE) administers, manages, plans, and evaluates agency functions in the areas of fiscal operations, human resources, information technology, and public information, under the guidance of the director. The Director's Office includes the director's staff, Financial Services, Public Information, Legal Unit, Human Resources, and Information Technology.

Oil and Gas Conservation Division (19.50 FTE) administers the Montana oil and gas conservation laws. It promotes conservation and prevents waste in the recovery of oil and gas resources through regulation of exploration and production. The division issues drilling permits; classifies wells; establishes well spacing units and pooling orders; inspects drilling, production, and seismic operations; investigates complaints; and does engineering studies. The division also determines incremental production for enhanced recovery and horizontal wells to implement the tax incentive program for those projects, operates the underground injection control program, plugs orphan wells, and collects and maintains complete well data and production information. The division provides administrative support to the Board of Oil and Gas Conservation.

Conservation and Resource Development Division (28.17 FTE) assists local entities in managing the state's natural resources and provides financing for conservation resource management and reclamation activities. The division is made up of three bureaus. The Conservation Districts Bureau provides technical, administrative, financial, and legal assistance to Montana's 58 conservation districts. The Financial Bureau issues loans for local communities, local governments, state agencies, and

private citizens. The programs include State Revolving Fund loans to communities for drinking water and waste water systems, Coal Severance Tax loans to governmental entities, and loans to private entities for water development projects. Loans outstanding exceed \$441 million at June 30, 2018. Grant programs administered by the Resource Development Bureau include the Reclamation and Development Grant Program and the Renewable Resource Grant Program.

Water Resources Division (133.76 FTE) is responsible for programs associated with the use, development, and protection of Montana's water. It manages and maintains state-owned dams, reservoirs, and canals. The division develops and recommends intrastate, interstate, and international water policy to the director, governor, and legislature. They released an updated "Montana State Water Plan" in 2015. The division also resolves water resource use conflicts, investigates water use violations, ensures dam safety compliance, and provides water adjudication support to the Water Court. The division consists of an administration unit and five bureaus: Water Adjudication Bureau, Water Management Bureau, Water Rights Bureau, Water Projects Bureau, and Water Operations Bureau.

Forestry/Trust Land Management Division (312.83 FTE) manages the forest resources of the state and state lands held in trust to provide income for various state educational facilities and institutions. The department fulfills these responsibilities in two administrative units.

- ◆ **Forestry** is responsible for planning and implementing forestry programs statewide. The division protects Montana's natural resources from wildfire, regulates forest practices, and provides a variety of services to private forest landowners. The Fire and Aviation Management Program protects 50 million acres of state and private forest and watershed lands from wildfire through a combination of direct protection and county support.

The Forest Practice Regulation Program enforces Montana's streamside management zone regulations and monitors the voluntary Best Management Practices on all forests in Montana. In administering Montana's Fire Hazard Reduction Law, the division helps ensure fire hazards created by logging and other forest management operations on private forestlands are adequately reduced, or that additional fire protection is provided until the hazard is reduced. The division provides technical forestry assistance to private landowners, businesses, and communities.

- ◆ **Trust Land Management** provides for the administration and management of trust lands granted, in part, to the state of Montana by the Enabling Act of 1889. In the process of producing revenue for trust beneficiaries, the division considers environmental factors and the future income-generating capacity of the trust lands. These lands currently total over 5.2 million surface acres and 6.2 million mineral acres. Additionally, the division is responsible for the administration of approximately 3,412 miles of the beds

of navigable waterways. The Trust Land Management Division is divided into four primary programs: forest management, agriculture and grazing management, real estate management, and minerals management.

Prior Audit Recommendations

The prior audit report contained eight recommendations. The department implemented five recommendations. The department partially implemented three recommendations. In fully implementing prior audit recommendations, the department added controls over timber sale information, substantially completed a physical inventory as required by state policy, updated state law regarding local government payments and reporting, and complied with state law regarding water activity reports and reviewing of water permits.

The first partially implemented recommendation relates to the segregation of duties regarding trust fund transfers and accounting entries in the State Revolving Fund Program and over the Blackfeet Mitigation Accounts. Transfers to the land grant trusts include over \$40 million dollars to the Common Schools Trust Fund in both fiscal years 2017 and 2018. The prior audit report recommends segregating duties with land grant transfers, entries in the State Revolving Fund Program, and entries relating to the Blackfeet Mitigation Accounts. The department added segregation to the land grant transfers involving the trust fund payments. There are now three staff members involved in the transfers to the trusts. The department did not add segregation to the accounting entries in the State Revolving Fund Program or over the Blackfeet Mitigation Accounts entries. See further discussion of this prior audit recommendation on page 8.

The next partially implemented audit recommendation relates to the department's inability to confirm hydroelectric trust fund revenue. The department was able to confirm revenue for fiscal year 2017 and most of fiscal year 2018. We reviewed documentation of the department asking for the information they needed to confirm all revenue in fiscal year 2018 and the information was not provided to them. The prior audit recommendation was to amend the agreement with the lessee if they are unable to confirm the revenue. The attorney general is responsible for making any updates to the agreement, because there is an ongoing legal dispute regarding hydroelectric activity. The department has requested the attorney general update the agreement, but it has not yet been updated. We make no further recommendations at this time.

The final partially implemented audit recommendation relates to inconsistency in implementing controls related to giving cash-like awards to employees and complying with federal law governing inclusion of gifts in the employee's income. The department

updated their control procedures as recommended, but our testing found the procedure was not followed for all gift cards during the audit period. See page 12 for more information on the prior audit recommendation.

Chapter II – Findings and Recommendations

Trust Funds Program

An accounting error led to a \$17 million misclassification on all schedules for fiscal year 2017.

The Department of Natural Resources and Conservation (department) misclassified Transfers-In and Transfers-Out activity in the Trust Funds program by coding the entries to program year 2016, instead of 2017. State law requires all transactions to be recorded in accordance with generally accepted accounting principles. This unintentional misclassification led to approximately \$17 million in revenue and expenditure activity being classified as prior year activity on all fiscal year 2017 schedules, instead of current year activity. The table below outlines the effect on the department's financial schedules from this misclassification. Each misstatement amount is approximately \$17 million.

Table 1
Summary of Misstatements on Fiscal Year 2017 Schedules

Schedule Name	Account	Schedule Amount	Correct Amount
Schedule of Changes in Fund Equity & Property Held in Trust	Nonbudgeted Revenues & Transfers-In	\$106,012,212	\$88,560,684
	Prior Year Revenues & Transfers-In Adjustments	(\$17,451,528)	\$0
	Nonbudgeted Expenditures & Transfers-Out	\$91,023,886	\$73,555,600
	Prior Year Expenditures & Transfers-Out Adjustments	(\$17,468,286)	\$0
Schedule of Total Revenues & Transfers-In	Nonbudgeted Revenues & Transfers-In	\$106,012,212	\$88,560,684
	Prior Year Revenues & Transfers-In Adjustments	(\$17,451,528)	\$0
Schedule of Total Expenditures & Transfers-Out	Nonbudgeted Expenditures & Transfers-Out	\$91,046,431	\$73,578,145
	Prior Year Expenditures & Transfers-Out Adjustments	(\$17,468,286)	\$0

Source: Compiled by the Legislative Audit Division.

The errors above resulted in the qualified opinions outlined in the Independent Auditor's Report on page A-1.

State accounting policy requires management to establish and maintain agency internal controls, a process that provides reasonable assurance the objectives of an entity will be achieved. We determined the control deficiency was a material weakness because a material misstatement did occur. The existing control procedures did not detect and correct the error.

The current control process did not allow for staff to detect this misclassification. Department staff stated there was no reminder to change the program year when updating the entry at fiscal year-end. The department improved the current procedure to address the risk of these types of misclassifications at fiscal year-end for 2018.

RECOMMENDATION #1

We recommend the Department of Natural Resources and Conservation monitor, and continue to update, internal controls for Land Grant accounting entries.

Segregation of Duties

Dual review will help prevent accounting errors.

At fiscal year-end, the department enters cash and investment balances into the state's accounting system using bank statements for the State Revolving Fund Programs and the Blackfeet Mitigation Accounts. This entry is entered and approved by the same individual. We found a \$3 million classification error in the Blackfeet asset accounts related to investment activity in fiscal year 2018. Similar misclassifications were also identified in the prior audit report. The error does not affect the department's schedules contained in this report, but does impact the state's basic financial statement preparation process, requiring corrections be made by Department of Administration personnel during the financial statement preparation process. State accounting policy requires the segregation of accounting entries. State policy states, ". . . proper segregation of duties is a necessary condition to make control procedures effective. Management should ensure adequate separation of the following responsibilities: authorization of transactions, recording of transactions, custody of assets, and periodic reconciliation of existing assets to recorded amounts." The department should separate the recording and approving of accounting transactions.

Department staff stated they did not add segregation to the State Revolving Fund entries or the Blackfeet Mitigation Account entries because it is a classification between investment accounts and no funds are leaving the treasury or the department. The classification involves determining if the asset should be coded as cash, a short-term investment, or a long-term investment. Management considers the activity low risk to the department. However, state policy notes having proper segregation of duties is a necessary condition to make control procedures effective. Having another staff member involved in the process would not be a significant cost of time and the segregation of duties will aid in identifying any misclassifications and is required by state policy. As noted above, the audit process has identified classification errors in the last two audits. The department's current process is not identifying these misclassifications. The department must have controls in place to prevent and detect misclassifications prior to the audit process. If adjustments are not made, there is risk the auditors are becoming part of the control structure. The accounting entries do not affect the department's schedules, but there is a risk to the state's overall accounting records. When the department relies on the audit process to detect errors in these account balances, an error can remain undetected and the items would be misclassified on the state's financial statements.

RECOMMENDATION #2

We recommend the Department of Natural Resources and Conservation segregate accounting duties related to the approval and review of accounting transactions involving the classification of assets related to the State Revolving Fund and Blackfeet Mitigation Funds.

Controls Over Procard Limits

The department did not have controls in place to reduce temporary increases to procard limits.

The state of Montana often uses credit cards to pay for expenses. The cards are commonly referred to as procurement cards, or procards. As part of our work, we reviewed significant procard purchases from the audit period. We identified four instances out of fifteen tested where temporary increases of \$10,000, \$25,000, \$50,000, or \$75,000 per month in procard authority were not subsequently reduced to the default limit of \$5,000 per month. State policy requires management to establish internal control policies and procedures designed to prevent theft, resource shortages,

operational inefficiency, a breakdown in the control structure, or negative publicity. The department's policy requires authorization to increase or decrease default procard limits, however, there is not a control to ensure temporary increases are reversed. In one case, the increased spending limit was specifically authorized for a month, but was not decreased at the end of the month. In the other three situations, the approval was temporary and should have decreased when conditions requiring the increase passed, but the decrease did not occur. Examples of the purchases we reviewed were rental cars and a group of hotel rooms. Department staff noted large limits are common because of the types of purchases people must make at the department due to fire season; currently 156 employees have limits greater than \$5,000 per month.

Department staff noted there was a procedure in place to always obtain authorization prior to the increase but there was not a focus on going back to reduce the limits after the temporary period was over and a procedure to remind staff to reduce the limits needs to be developed. Risk of procard mismanagement increases when employee limits are more than their business needs. Procedures are needed to ensure increases permitted on a temporary basis are reduced as intended. The fifteen transactions we reviewed for this testing were supported and properly authorized.

RECOMMENDATION #3

We recommend the Department of Natural Resources and Conservation implement controls to reduce temporary increases in procard limits when the period requiring the increase is over.

Flathead Basin Commission

The department can improve compliance with reporting and revenue collection requirements.

The Flathead Basin Commission (commission) is administratively attached to the department. The purpose of the commission is to protect Flathead Lake, the waters that flow into and out of it, and the environment of the Flathead Basin. The commission is required by §75-7-304 (6), MCA, to submit a report to the governor and to the legislature describing how they have fulfilled their duties required by law. These duties include monitoring the Flathead Basin's natural resources, identifying land use and trends in the Basin, making recommendations for continued preservation of the Flathead Basin, and reporting on all money received and expended by source

and purpose for the period since the last report. Section 5-11-210 (2), MCA, requires a report summary to be submitted to the legislature by September 1 prior to the regular session.

The commission, through the department, did not submit a biennial report summary to the legislature by September 1, 2016. This report, for fiscal years 2015 and 2016, has since been submitted to the legislature. In addition, the commission had not completed a report for the next biennium as of September 2018, and the department was unable to ensure all fundraising revenue raised by the commission was deposited in the state's accounting system and state treasury during fiscal year 2017 and 2018 as required by §2-15-121 (2) MCA. The law also requires the department to:

- “(a) direct and supervise the budgeting, recordkeeping, reporting, and related administrative and clerical functions of the agency;
- (b) include the agency's budgetary requests in the departmental budget;
- (c) collect all revenues for the agency and deposit them in the proper fund or account. Except as provided in 37-1-101, the department may not use or divert the revenues from the fund or account for purposes other than provided by law.
- (d) provide staff for the agency. Unless otherwise indicated in this chapter, the agency may not hire its own personnel.
- (e) print and disseminate for the agency any required notices, rules, or orders adopted, amended, or repealed by the agency.”

The department brought the fundraising revenue concern to our attention prior to the audit and has taken steps to address the issue. These steps include identifying two donations intended for the commission but redirected to another organization and making personnel changes. The intercepted donations were \$2,000 and \$8,000 donations. There is additional risk donations intended for the commission may not have been received and reported by the commission or the department. State policy requires the department to have adequate controls in place to help ensure compliance with applicable laws and regulations, and the department should consider controls they can add into the relationship with the commission to prevent such concerns in the future. By ensuring all revenue is received and reported, the legislature is able to evaluate the resources available for addressing the needs of the Flathead Basin.

RECOMMENDATION #4

We recommend the Department of Natural Resources and Conservation develop controls to monitor and facilitate compliance with reporting requirements in state law and ensure completeness of fundraising revenue for the Flathead Basin Commission.

Employee Awards

Controls over employee awards should be implemented.

Department policy allows for a variety of annual awards for employee recognition purposes. Awards are based upon the recommendation of the appropriate supervisors and can be an agency, or bureau specific, award. The department spent approximately \$16,000 in fiscal year 2017 and \$12,600 in fiscal year 2018 on annual awards for employees. In the prior audit, it was recommended the department add controls to ensure employees receive their gift card awards, and the cash-like awards are taxed as required. The department updated their control procedures as recommended by adding a signature that the employee received the award. The signature page is given to payroll to be recorded on the employee's paycheck as taxable income to the employee. Our testing found the procedure was not followed for all gift cards during the audit period. The award amounts we reviewed without all required controls in place were between \$50 to \$464 per person. State policy requires management to implement control activity through policies. We tested six gift card awards during the audit period and only one followed all the required control procedures.

There is a control deficiency in operation when the control is not being completed on a consistent basis. Gift cards have value to anyone possessing them and without documentation to confirm the intended recipient received the awards, the department is at risk of awards being misused. Department staff noted they discussed the new control when they first implemented it, but the control is not being completed on a consistent basis.

RECOMMENDATION #5

We recommend the Department of Natural Resources and Conservation consistently implement controls over employee awards.

Independent Auditor's Report and Department Financial Schedules

LEGISLATIVE AUDIT DIVISION

Angus Maciver, Legislative Auditor
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors
Cindy Jorgenson
Joe Murray

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

Introduction

We have audited the accompanying Schedules of Changes in Fund Equity & Property Held in Trust, Schedules of Total Revenues & Transfers-In, and Schedules of Total Expenditures & Transfers-Out of the Department of Natural Resources and Conservation for each of the fiscal years ended June 30, 2018, and 2017, and the related notes to the financial schedules.

Management's Responsibility for the Financial Schedules

Management is responsible for the preparation and fair presentation of these financial schedules in accordance with the regulatory format prescribed by the Legislative Audit Committee, based on the transactions posted to the state's accounting system without adjustment; this responsibility includes recording transactions in accordance with state accounting policy; and designing, implementing, and maintaining internal controls relevant to the preparation and fair presentation of the financial schedules that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial schedules. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial schedules, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the department's preparation and fair presentation of the financial schedules in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the department's internal control, and accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as the overall presentation of the financial schedules.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Basis for Adverse Opinions on U.S. Generally Accepted Accounting Principles

As described in Note 1, the financial schedules are prepared from the transactions posted to the state's primary accounting system without adjustment, in the regulatory format prescribed by the Legislative Audit Committee. This is a basis of accounting other than accounting principles generally accepted in the United States of America. The financial schedules are not intended to, and do not, report assets, liabilities, and cash flows.

The effects on the financial schedules of the variances between the regulatory basis of accounting described in Note 1 and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

Adverse Opinions on U.S. Generally Accepted Accounting Principles

In our opinion, because of the significance of the matter discussed in the "Basis for Adverse Opinions on U.S. Generally Accepted Accounting Principles" paragraph, the financial schedules referred to above do not present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of the department as of June 30, 2018, and June 30, 2017, or changes in financial position or cash flows for the years then ended.

Basis for Qualified Opinions on Regulatory Basis of Accounting

In fiscal year 2017, Transfers-In and Transfers-Out in the Trust Funds Program and Permanent Fund were unintentionally recorded to program year 2016 instead of 2017. The error led to a \$17 million misstatement on the schedules for fiscal year 2017. The effect of the error is presented on the following table. Each misstatement amount is approximately \$17 million.

Schedule Name	Account	Schedule Amount	Correct Amount
Schedule of Changes in Fund Equity & Property Held in Trust	Nonbudgeted Revenues & Transfers-In	\$106,012,212	\$88,560,684
	Prior Year Revenues & Transfers-In Adjustments	(\$17,451,528)	\$0
	Nonbudgeted Expenditures & Transfers-Out	\$91,023,886	\$73,555,600
	Prior Year Expenditures & Transfers-Out Adjustments	(\$17,468,286)	\$0
Schedule of Total Revenues & Transfers-In	Nonbudgeted Revenues & Transfers-In	\$106,012,212	\$88,560,684
	Prior Year Revenues & Transfers-In Adjustments	(\$17,451,528)	\$0
Schedule of Total Expenditures & Transfers-Out	Nonbudgeted Expenditures & Transfers-Out	\$91,046,431	\$73,578,145
	Prior Year Expenditures & Transfers-Out Adjustments	(\$17,468,286)	\$0

Qualified Opinions on Regulatory Basis of Accounting

In our opinion, except for the effects of the matter described in the “Basis for Qualified Opinions” paragraph, the Schedule of Changes in Fund Equity & Property Held in Trust, Schedule of Total Revenues & Transfers-In, and Schedule of Total Expenditures & Transfers-Out present fairly, in all material respects, the results of operations and changes in fund equity and property held in trust of the department for the fiscal year ended June 30, 2017, in conformity with the basis of accounting described in Note 1.

Unmodified Opinions on Regulatory Basis of Accounting

In our opinion, the Schedule of Changes in Fund Equity & Property Held in Trust, Schedule of Total Revenues & Transfers-In, and Schedule of Total Expenditures & Transfers-Out for the fiscal year ended June 30, 2018, presents fairly, in all material respects, the results of operations and changes in fund equity and property held in trust of the Department of Natural Resources and Conservation, in conformity with the basis of accounting described in Note 1.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 3, 2018, 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the department’s internal control over financial reporting and compliance.

Respectfully submitted,

/s/ Cindy Jorgenson

Cindy Jorgenson, CPA
Deputy Legislative Auditor
Helena, MT

October 3, 2018

DEPARTMENT OF NATURAL RESOURCES AND CONSERVATION
 SCHEDULE OF CHANGES IN FUND EQUITY & PROPERTY HELD IN TRUST
 FOR THE FISCAL YEAR ENDED JUNE 30, 2018

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Debt Service Fund	Enterprise Fund	Internal Service Fund	Agency Fund	Private Purpose Trust Fund	Permanent Fund
FUND EQUITY: July 1, 2017	\$ (11,365,931)	\$ 589,409,122	\$ (16,540,146)	\$ 38,142,981	\$ (166,432)	\$ (1,186,475)	\$ 0	\$ 962,243	\$ 724,963,532
PROPERTY HELD IN TRUST: July 1, 2017							\$ 2,798,258		
ADDITIONS									
Budgeted Revenues & Transfers-In	223,343	224,154,045	13,596,648		518,950	3,093,353			
Nonbudgeted Revenues & Transfers-In	24,433	48,466,881	1,756	20,512,739	4,425	16,600		496,180	68,945,324
Prior Year Revenues & Transfers-In Adjustments		41,113	(38)	17,194					
Direct Entries to Fund Equity	30,113,342	(41,832,470)	357,493	554,053	180,371	433,851			5,834
Additions to Property Held in Trust							3,707,180		
Total Additions	<u>30,361,117</u>	<u>230,829,569</u>	<u>13,955,859</u>	<u>21,083,986</u>	<u>703,746</u>	<u>3,543,804</u>	<u>3,707,180</u>	<u>496,180</u>	<u>68,951,158</u>
REDUCTIONS									
Budgeted Expenditures & Transfers-Out	24,709,808	96,601,931	36,602,269		540,286	2,606,969			
Nonbudgeted Expenditures & Transfers-Out	(41,448)	167,001,655	(4,630,463)	25,236,752	19,958	60,637		445,215	84,275,288
Prior Year Expenditures & Transfers-Out Adjustments	(5,738)	(927,116)		(115,991)		269			
Reductions in Property Held in Trust							1,639,228		
Total Reductions	<u>24,662,623</u>	<u>262,676,470</u>	<u>31,971,806</u>	<u>25,120,760</u>	<u>560,244</u>	<u>2,667,874</u>	<u>1,639,228</u>	<u>445,215</u>	<u>84,275,288</u>
FUND EQUITY: June 30, 2018	\$ (5,667,437)	\$ 557,562,220	\$ (34,556,093)	\$ 34,106,207	\$ (22,930)	\$ (310,545)	\$ 0	\$ 1,013,208	\$ 709,639,401
PROPERTY HELD IN TRUST: June 30, 2018							\$ 4,866,210		

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF NATURAL RESOURCES AND CONSERVATION
SCHEDULE OF CHANGES IN FUND EQUITY & PROPERTY HELD IN TRUST
FOR THE FISCAL YEAR ENDED JUNE 30, 2017

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Debt Service Fund	Enterprise Fund	Internal Service Fund	Agency Fund	Private Purpose Trust Fund	Permanent Fund
FUND EQUITY: July 1, 2016	\$ (14,974,678)	\$ 586,440,191	\$ (18,363,042)	\$ 36,471,004	\$ (101,355)	\$ (576,875)	\$ 0	\$ 973,389	\$ 709,939,446
PROPERTY HELD IN TRUST: July 1, 2016							\$ 3,858,236		
ADDITIONS									
Budgeted Revenues & Transfers-In	284,038	227,373,524	14,356,376		506,473	2,277,039			
Nonbudgeted Revenues & Transfers-In	16,506	16,391,107	1,163	25,446,072	5,104	20,605		507,722	106,012,212
Prior Year Revenues & Transfers-In Adjustments	6,196	525,853	(69)	(178)	(13,813)	5,895			(17,451,528)
Direct Entries to Fund Equity	32,824,661	(28,564,150)	186,704	525,962		11,141			19,001
Additions to Property Held in Trust							4,046,067		
Total Additions	<u>33,131,400</u>	<u>215,726,335</u>	<u>14,544,175</u>	<u>25,971,855</u>	<u>497,765</u>	<u>2,314,680</u>	<u>4,046,067</u>	<u>507,722</u>	<u>88,579,686</u>
REDUCTIONS									
Budgeted Expenditures & Transfers-Out	29,517,537	74,870,000	17,514,391		534,966	2,801,486			
Nonbudgeted Expenditures & Transfers-Out	10,132	137,589,192	(4,793,112)	24,353,418	27,876	36,506		518,868	91,023,886
Prior Year Expenditures & Transfers-Out Adjustments	(5,016)	298,213		(53,539)		86,288			(17,468,286)
Reductions in Property Held in Trust							5,106,045		
Total Reductions	<u>29,522,653</u>	<u>212,757,404</u>	<u>12,721,279</u>	<u>24,299,879</u>	<u>562,842</u>	<u>2,924,281</u>	<u>5,106,045</u>	<u>518,868</u>	<u>73,555,600</u>
FUND EQUITY: June 30, 2017	\$ (11,365,931)	\$ 589,409,122	\$ (16,540,146)	\$ 38,142,981	\$ (166,432)	\$ (1,186,475)	\$ 0	\$ 962,243	\$ 724,963,532
PROPERTY HELD IN TRUST: June 30, 2017							\$ 2,798,258		

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF NATURAL RESOURCES AND CONSERVATION
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2018

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Debt Service Fund	Enterprise Fund	Internal Service Fund	Private Purpose Trust Fund	Permanent Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS									
Licenses and Permits	\$ 5,571	\$ 261,727						\$ 1,455,928	\$ 1,723,227
Taxes		3,823,990	\$ 1,756						3,825,746
Charges for Services	109,645	3,003,997				\$ 1,448,701			4,562,343
Investment Earnings		3,408,098		\$ 10,599,335				2,135,448	16,142,880
Fines and Forfeits	28,790	216,042							244,832
Monetary Settlements		22,000							22,000
Capital Contributions	7,674								7,674
Sale of Documents, Merchandise and Property	6,850	3,605,948		1,073,506	\$ 518,950			10,519,210	15,724,464
Rentals, Leases and Royalties	6,771	225,875						50,704,010	50,936,657
Grants, Contracts, and Donations	505	227,514			4,425	16,600	\$ 496,180	403	745,626
Transfers-in		257,520,693	36,539	8,857,092		1,644,652		1,860,948	269,919,924
Capital Asset Sale Proceeds	77,536	83,422	24,300					2,269,377	2,454,635
Federal Indirect Cost Recoveries			543,614						543,614
Miscellaneous	4,432	262,733							267,166
Federal			12,992,157						12,992,157
Total Revenues & Transfers-In	247,776	272,662,039	13,598,366	20,529,933	523,375	3,109,953	496,180	68,945,324	380,112,945
Less: Nonbudgeted Revenues & Transfers-In	24,433	48,466,881	1,756	20,512,739	4,425	16,600	496,180	68,945,324	138,468,337
Prior Year Revenues & Transfers-In Adjustments		41,113	(38)	17,194					58,269
Actual Budgeted Revenues & Transfers-In	223,343	224,154,045	13,596,648	0	518,950	3,093,353	0	0	241,586,339
Estimated Revenues & Transfers-In	223,586	224,155,199	13,596,840	0	518,950	3,093,353	0	0	241,587,928
Budgeted Revenues & Transfers-In Over (Under) Estimated	\$ (243)	\$ (1,154)	\$ (192)	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ (1,589)
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS									
Licenses and Permits	\$ (29)	\$ (200)							\$ (229)
Charges for Services	(495)	(482)							(977)
Investment Earnings		(34)	\$ (110)						(144)
Capital Contributions	(1)								(1)
Sale of Documents, Merchandise and Property	(150)	50							(100)
Grants, Contracts, and Donations	5								5
Transfers-in			358						358
Federal Indirect Cost Recoveries			188						188
Miscellaneous	426	(488)							(62)
Federal			(628)						(628)
Budgeted Revenues & Transfers-In Over (Under) Estimated	\$ (243)	\$ (1,154)	\$ (192)	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ (1,589)

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF NATURAL RESOURCES AND CONSERVATION
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2017

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Debt Service Fund	Enterprise Fund	Internal Service Fund	Private Purpose Trust Fund	Permanent Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS									
Licenses and Permits	\$ 475	\$ 262,687						\$ 1,550,931	\$ 1,814,094
Taxes		3,597,028	\$ 1,163						3,598,191
Charges for Services	83,934	2,907,509		\$ 260		\$ 838,282			3,829,985
Investment Earnings		3,167,473		9,772,792				6,340,089	19,280,353
Fines and Forfeits	17,284	38,415							55,699
Capital Contributions	29,172								29,172
Sale of Documents, Merchandise and Property	5,285	876,447		4,240,950	\$ 492,646			10,952,057	16,567,385
Rentals, Leases and Royalties	7,953	135,546						48,369,547	48,513,045
Grants, Contracts, and Donations		205,976	70,083		5,104	20,605	\$ 507,722	325	809,816
Transfers-in		233,052,146	136,743	11,431,893		1,444,652		6,164,324	252,229,758
Capital Asset Sale Proceeds	159,333	42,358						15,183,411	15,385,102
Federal Indirect Cost Recoveries			396,791						396,791
Miscellaneous	3,305	4,899			15				8,218
Federal			13,752,690						13,752,690
Total Revenues & Transfers-In	306,740	244,290,485	14,357,470	25,445,894	497,765	2,303,539	507,722	88,560,685	376,270,299
Less: Nonbudgeted Revenues & Transfers-In	16,506	16,391,107	1,163	25,446,072	5,104	20,605	507,722	106,012,212	148,400,492
Prior Year Revenues & Transfers-In Adjustments	6,196	525,853	(69)	(178)	(13,813)	5,895		(17,451,528)	(16,927,643)
Actual Budgeted Revenues & Transfers-In	284,038	227,373,524	14,356,376	0	506,473	2,277,039	0	0	244,797,450
Estimated Revenues & Transfers-In	284,038	227,373,524	14,348,965		506,473	2,277,039			244,790,039
Budgeted Revenues & Transfers-In Over (Under) Estimated	\$ 0	\$ 0	\$ 7,411	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 7,411
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS									
Federal Indirect Cost Recoveries			\$ (2,606)						\$ (2,606)
Federal			10,017						10,017
Budgeted Revenues & Transfers-In Over (Under) Estimated	\$ 0	\$ 0	\$ 7,411	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 7,411

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPT NAT RESOURCE/CONSERVATION
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2018

PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT	Conservation & Resource Development Division	Director's Office	Forestry & Trust Lands	Oil & Gas Conservation Division	Trust Funds	Water Resources Division	Total
Personal Services							
Salaries	\$ 1,803,040	\$ 3,528,997	\$ 15,847,920	\$ 957,094		\$ 7,555,003	\$ 29,692,053
Hourly Wages			7,787,160				7,787,160
Other Compensation	375			6,800		300	7,475
Employee Benefits	617,885	1,164,177	6,961,040	338,934		2,730,883	11,812,918
Personal Services-Other			(7,459)				(7,459)
Total	<u>2,421,300</u>	<u>4,693,174</u>	<u>30,588,661</u>	<u>1,302,828</u>		<u>10,286,185</u>	<u>49,292,148</u>
Operating Expenses							
Other Services	2,147,090	480,252	64,798,746	322,824		4,496,816	72,245,728
Supplies & Materials	88,231	217,446	3,670,751	46,633		218,492	4,241,552
Communications	50,362	208,501	749,271	57,930		245,487	1,311,552
Travel	84,875	23,364	2,138,633	27,992		97,881	2,372,745
Rent	237,427	450,932	9,992,970	22,063		730,935	11,434,328
Utilities			254,244	18,234		16,967	289,445
Repair & Maintenance	5,173	4,167	1,663,400	35,358		32,893	1,740,989
Other Expenses	139,425	43,079	746,141	35,269		689,686	1,653,599
Total	<u>2,752,583</u>	<u>1,427,741</u>	<u>84,014,156</u>	<u>566,302</u>		<u>6,529,156</u>	<u>95,289,938</u>
Equipment & Intangible Assets							
Equipment			938,873	29,849		97,515	1,066,237
Total			<u>938,873</u>	<u>29,849</u>		<u>97,515</u>	<u>1,066,237</u>
Capital Outlay							
Land & Interest In Land			11,067		\$ 16,056,844	1,013,103	17,081,013
Buildings			139,091				139,091
Total			<u>150,158</u>		<u>16,056,844</u>	<u>1,013,103</u>	<u>17,220,105</u>
Local Assistance							
Total							
Grants							
From State Sources	2,125,351		70,900				2,196,251
From Federal Sources	308,601		2,344,181				2,652,782
Total	<u>2,433,953</u>		<u>2,415,081</u>				<u>4,849,033</u>
Benefits & Claims							
From Other Sources			445,215				445,215
Other Financing Uses/Deduction	4,630,463						4,630,463
Total	<u>4,630,463</u>		<u>445,215</u>				<u>5,075,678</u>
Transfers-out							
Fund transfers	147,619,245	95	32,642,267	195,000	64,239,275	2,139,736	246,835,617
Intra-Entity Expense			26,012		4,226,905		4,252,917
Total	<u>147,619,245</u>	<u>95</u>	<u>32,668,279</u>	<u>195,000</u>	<u>68,466,180</u>	<u>2,139,736</u>	<u>251,088,534</u>
Debt Service							
Bonds	7,212,814						7,212,814
Loans	410,804					673,582	1,084,385
Capital Leases		5,484					5,484
Total	<u>7,623,618</u>	<u>5,484</u>				<u>673,582</u>	<u>8,302,683</u>
Post Employment Benefits							
Other Post Employment Benefits			6,165				6,165
Employer Pension Expense			189,759				189,759
Total			<u>195,924</u>				<u>195,924</u>
Total Expenditures & Transfers-Out	\$ <u>167,481,161</u>	\$ <u>6,126,493</u>	\$ <u>151,416,347</u>	\$ <u>2,093,979</u>	\$ <u>84,523,024</u>	\$ <u>20,739,275</u>	\$ <u>432,380,280</u>
EXPENDITURES & TRANSFERS-OUT BY FUND							
General Fund	\$ 1,509,962	\$ 3,419,320	\$ 11,928,679			\$ 7,804,663	\$ 24,662,623
State Special Revenue Fund	140,083,845	2,179,769	108,042,901	2,039,127	\$ 247,736	10,083,090	262,676,470
Federal Special Revenue Fund	766,594	527,404	27,771,434	54,852		2,851,522	31,971,806
Debt Service Fund	25,120,760						25,120,760
Enterprise Fund			560,244				560,244
Internal Service Fund			2,667,874				2,667,874
Private Purpose Trust Fund			445,215				445,215
Permanent Fund					84,275,288		84,275,288
Total Expenditures & Transfers-Out	<u>167,481,161</u>	<u>6,126,493</u>	<u>151,416,347</u>	<u>2,093,979</u>	<u>84,523,024</u>	<u>20,739,275</u>	<u>432,380,280</u>
Less: Nonbudgeted Expenditures & Transfers-Out	153,945,542	(2,581)	31,341,342	196,386	84,523,024	2,363,881	272,367,594
Prior Year Expenditures & Transfers-Out Adjustments	(21,976)	11,913	(1,011,351)	329		(27,491)	(1,048,576)
Actual Budgeted Expenditures & Transfers-Out	<u>13,557,594</u>	<u>6,117,161</u>	<u>121,086,356</u>	<u>1,897,265</u>	<u>0</u>	<u>18,402,886</u>	<u>161,061,262</u>
Budget Authority	40,401,211	6,303,176	144,421,183	3,138,434		42,279,709	236,543,714
Unspent Budget Authority	\$ <u>26,843,617</u>	\$ <u>186,015</u>	\$ <u>23,334,827</u>	\$ <u>1,241,169</u>	\$ <u>0</u>	\$ <u>23,876,824</u>	\$ <u>75,482,451</u>
UNSPENT BUDGET AUTHORITY BY FUND							
General Fund	\$ 9,214	\$ 133,260	\$ 9,546			\$ 119,464	\$ 271,485
State Special Revenue Fund	20,320,901		13,428,774	1,199,601		21,248,288	56,197,566
Federal Special Revenue Fund	6,513,502	52,755	9,587,994	41,568		2,509,071	18,704,889
Enterprise Fund			245,860				245,860
Internal Service Fund			62,652				62,652
Unspent Budget Authority	\$ <u>26,843,617</u>	\$ <u>186,015</u>	\$ <u>23,334,827</u>	\$ <u>1,241,169</u>	\$ <u>0</u>	\$ <u>23,876,824</u>	\$ <u>75,482,451</u>

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-9.

DEPARTMENT OF NATURAL RESOURCES AND CONSERVATION
 SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
 FOR THE FISCAL YEAR ENDED JUNE 30, 2017

PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT	Conservation/Resource Development Division	Director's Office	Forestry/Trust Lands Division	Oil & Gas Conservation Division	Trust Funds	Water Resources Division	Total
Personal Services							
Salaries	\$ 1,841,137	\$ 3,510,034	\$ 14,650,624	\$ 975,876		\$ 7,736,317	\$ 28,713,989
Hourly Wages			5,112,589				5,112,589
Other Compensation	525			7,050		350	7,925
Employee Benefits	679,350	1,264,656	7,009,070	374,494		3,035,741	12,363,311
Personal Services-Other			31,786				31,786
Total	2,521,012	4,774,691	26,804,068	1,357,420		10,772,408	46,229,599
Operating Expenses							
Other Services	5,514,920	464,001	19,090,974	423,063		4,009,488	29,502,446
Supplies & Materials	87,794	341,266	2,355,930	50,921		370,434	3,206,344
Communications	51,555	170,027	647,007	51,949		232,544	1,153,081
Travel	154,543	42,936	1,264,083	27,878		154,561	1,644,001
Rent	248,755	423,392	2,844,646	25,460		700,102	4,242,354
Utilities	3,398	5,251	238,612	19,386		16,018	282,666
Repair & Maintenance	10,988	6,363	1,486,140	35,171		115,110	1,653,771
Other Expenses	112,667	72,317	733,639	33,797		447,087	1,399,508
Total	6,184,621	1,525,552	28,661,031	667,624		6,045,343	43,084,172
Equipment & Intangible Assets							
Equipment	4,265		1,679,580	72,607		115,817	1,872,269
Total	4,265		1,679,580	72,607		115,817	1,872,269
Capital Outlay							
Land & Interest In Land			30,000		\$ 1,332,384	955,765	2,318,150
Buildings			10,330				10,330
Total			40,330		1,332,384	955,765	2,328,480
Local Assistance							
Total							
Grants							
From State Sources	9,783,762		4,592,268				14,376,030
From Federal Sources	14,465		2,653,500				2,667,965
Total	9,798,227		7,245,768				17,043,995
Benefits & Claims							
From Other Sources			518,868				518,868
Other Financing Uses/Deduction	4,793,112						4,793,112
Total	4,793,112		518,868				5,311,980
Transfers-out							
Fund transfers	156,149,201	1,501,262	1,613,102		67,856,053	26,944	227,146,562
Intra-Entity Expense			35,623		4,389,707		4,425,330
Total	156,149,201	1,501,262	1,648,725		72,245,760	26,944	231,571,892
Debt Service							
Bonds	8,022,135						8,022,135
Loans	517,976					659,814	1,177,791
Capital Leases		27,144					27,144
Total	8,540,111	27,144				659,814	9,227,070
Post Employment Benefits							
Other Post Employment Benefits			63,640				63,640
Employer Pension Expense			129,708				129,708
Total			193,348				193,348
Total Expenditures & Transfers-Out	\$ 187,990,549	\$ 7,828,649	\$ 66,791,718	\$ 2,097,652	\$ 73,578,145	\$ 18,576,092	\$ 356,862,805
EXPENDITURES & TRANSFERS-OUT BY FUND							
General Fund	\$ 2,179,133	\$ 5,197,525	\$ 12,330,821			\$ 9,815,175	\$ 29,522,653
State Special Revenue Fund	160,982,758	2,305,205	40,696,918	\$ 1,991,976	\$ 22,545	6,758,002	212,757,404
Federal Special Revenue Fund	528,779	325,920	9,757,989	105,676		2,002,915	12,721,279
Debt Service Fund	24,299,879						24,299,879
Enterprise Fund			562,842				562,842
Internal Service Fund			2,924,281				2,924,281
Private Purpose Trust Fund			518,868				518,868
Permanent Fund					73,555,600		73,555,600
Total Expenditures & Transfers-Out	187,990,549	7,828,649	66,791,718	2,097,652	73,578,145	18,576,092	356,862,805
Less: Nonbudgeted Expenditures & Transfers-Out	156,788,961	(1,933)	717,627	1,764	91,046,431	213,916	248,766,766
Prior Year Expenditures & Transfers-Out Adjustments	411,414	(2,198)	(41,551)	(34,736)	(17,468,286)	(6,983)	(17,142,341)
Actual Budgeted Expenditures & Transfers-Out	30,790,174	7,832,781	66,115,642	2,130,624	0	18,369,159	125,238,380
Budget Authority	66,558,920	8,164,427	77,566,257	2,785,015		43,228,515	198,303,135
Unspent Budget Authority	\$ 35,768,746	\$ 331,646	\$ 11,450,615	\$ 654,392	\$ 0	\$ 24,859,356	\$ 73,064,755
UNSPENT BUDGET AUTHORITY BY FUND							
General Fund	\$ 36,912	\$ 212,076	\$ 398,225			\$ 153,972	\$ 801,185
State Special Revenue Fund	30,020,669	84,156	2,482,853	\$ 654,392		23,241,121	56,483,190
Federal Special Revenue Fund	5,711,166	35,414	8,301,669			1,464,263	15,512,512
Enterprise Fund			160,902				160,902
Internal Service Fund			106,966				106,966
Unspent Budget Authority	\$ 35,768,746	\$ 331,646	\$ 11,450,615	\$ 654,392	\$ 0	\$ 24,859,356	\$ 73,064,755

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

Department of Natural Resources and Conservation

Notes to the Financial Schedules

For the Two Fiscal Years Ended June 30, 2018

1. Summary of Significant Accounting Policies

Basis of Accounting

The department uses the modified accrual basis of accounting, as defined by state accounting policy, for its Governmental fund category (General, State Special Revenue, Federal Special Revenue, Debt Service, and Permanent). In applying the modified accrual basis, the department records:

- ◆ Revenues when it receives cash or when receipts are realizable, measurable, earned, and available to pay current period liabilities.
- ◆ Expenditures for valid obligations when the department incurs the related liability and it is measurable, with the exception of the cost of employees' annual and sick leave. State accounting policy requires the department to record the cost of employees' annual and sick leave when used or paid.

The department uses accrual basis accounting for its Proprietary (Enterprise and Internal Service) and Fiduciary (Private-Purpose Trust and Agency) fund categories. Under the accrual basis, as defined by state accounting policy, the department records revenues in the accounting period when realizable, measurable, and earned, and records expenses in the period incurred when measurable.

Expenditures and expenses may include: entire budgeted service contracts even though the department receives the services in a subsequent fiscal year; goods ordered with a purchase order before fiscal year-end, but not received as of fiscal year-end; and equipment ordered with a purchase order before fiscal year-end.

Basis of Presentation

The financial schedule format was adopted by the Legislative Audit Committee. The financial schedules are prepared from the transactions posted to the state's accounting system without adjustment.

The department uses the following funds:

Governmental Fund Category

- ◆ **General Fund** – to account for all financial resources except those required to be accounted for in another fund. The department uses general funds for a portion of the operation of the Director's Office, Conservation & Resource Development Division, Water Resources Division, and Forestry Division.

In addition, general funds are used for conservation district grants and administration, fire pre-suppression and forest practices.

- ◆ **State Special Revenue Fund** – to account for proceeds of specific revenue sources (other than private-purpose trusts or major capital projects) that are legally restricted to expenditures for specific state program purposes. Department State Special Revenue Funds include forestry operations, Water Pollution Control and Drinking Water State Revolving Fund (SRF) Programs, Renewable Resource Grant and Loan Program, and trust lands administration.
- ◆ **Federal Special Revenue Fund** – to account for activities funded from federal revenue sources. Department Federal Special Revenue Funds include forest stewardship, fire operations and suppression efforts, and Water Pollution Control and Drinking Water SRF Programs. Both SRF programs are financed in part by federal funds.
- ◆ **Debt Service Fund** – to account for accumulated resources for the payment of general long-term debt principal and interest. The department uses Debt Services Funds to account for Renewable Resources, Coal Severance Tax (CST) and Water Pollution Control and Drinking Water SRF Programs bond payments.
- ◆ **Permanent Fund** – to account for financial resources that are permanently restricted to the extent that only earnings, and not principal, may be used for purposes that support the department's programs. The department uses this fund for the Common School Trust, university and college trusts, School for the Deaf and Blind Trust, Pine Hills School Trust, Veteran's Home Trust, Public Land Trust, Lands Acquired Trust (Potomac Land), and the Trust and Legacy Account.

Proprietary Fund Category

- ◆ **Internal Service Fund** – to account for the financing of goods or services provided by one department or agency to other departments or agencies of state government or to other governmental entities on a cost-reimbursement basis. The department Internal Service Fund contains the Forestry Division's Air Operations Program. The Air Operations Program maintains and operates aircraft to aid in fire suppression.
- ◆ **Enterprise Fund** – to account for operations (a) financed and operated in a manner similar to private business enterprises, where the Legislature intends that the department finance or recover costs primarily through user charges; (b) where the Legislature has decided that periodic determination of revenues earned, expenses incurred or net income is appropriate; (c) where the activity is financed solely by a pledge of the net revenues from fees and charges of the activity; or (d) when laws or regulations require that the activities' cost of providing services, including capital costs, be recovered with fees and charges rather than with taxes or similar revenues. The department accounts for the State Seedling Nursery Program in this fund.

Fiduciary Fund Category

- ◆ **Private-Purpose Trust Fund** – to account for activity of any trust arrangement not properly reported in a pension fund or an investment trust fund where the principal and income benefit individuals, private organizations, or other governments. Department private-purpose trust fund is used to account for the cash bonds property held in trust and deposits payable collected as required in the fire hazard reduction agreement per 76-13-408, MCA.
- ◆ **Agency Fund** – to account for resources held by the state in a custodial capacity. Agency funds may be used on a limited basis for internal (to the State) clearing account activity but these must have a zero balance at fiscal year-end. The department agency funds account for activity such as receipt of cash for contract performance security and for bonding and property held in trust as required by various programs that generate revenue on state trust lands.

2. General Fund Equity Balance

The negative fund equity balance in the General Fund does not indicate overspent appropriation authority. The department has authority to pay obligations from the statewide General Fund within its appropriation limits. The department expends cash or other assets from the statewide fund when it pays General Fund obligations. The department's outstanding liabilities exceed the assets it has placed in the fund, resulting in negative ending General Fund equity balances for each of the fiscal years ended June 30, 2017 and June 30, 2018.

3. Federal Special Revenue Funds Equity Balance

The negative fund equity balance in the federal special revenue funds is due to fire expenditures that are to be reimbursed by federal agencies. However, revenue cannot be recorded since the reimbursements are not anticipated to be received within 60 days of the close of each fiscal year. A liability is recorded in the unavailable inflow of resources account instead of revenue. This entry creates the negative fund equity balance.

4. Direct Entries to Fund Equity

Direct entries to fund equity in the General, State Special Revenue, Federal Special Revenue Fund, Debt Service, Enterprise, Internal Service and Permanent funds primarily include entries generated by SABHRS to reflect the flow of resources within individual funds shared by separate agencies.

Direct entries to fund equity in the enterprise and internal service funds are due to mandated entries by the Governmental Accounting Standards Board (GASB) in conjunction with the requirement to address accounting and financial reporting for pensions and other post-employment benefits (OPEB). The department recorded to

fund equity approximately \$180,000 in the enterprise fund in fiscal year 2017-18 to reflect entries from fiscal year 2016-17 and earlier and approximately \$435,000 in the internal service fund in fiscal year 2017-18 to reflect entries from fiscal year 2016-17 and earlier.

5. Long-Term Debt

In fiscal year 2017-18 and in prior fiscal years, the state of Montana issued General Obligation (GO) bonds for the Water Pollution Control and Drinking Water SRF Programs. The bond proceeds were used for Water Pollution Control and Drinking Water project loans. At June 30, 2018, the department had a total of \$28,345,000 in GO bonds outstanding for these programs. The total GO bonds outstanding include a large bond issue in fiscal year 2014-15 of \$24,365,000 in the Water Pollution Control SRF program.

In fiscal year 2017-18 and in prior fiscal years, the state of Montana issued GO public and private bonds for the Renewable Resource Grant and Loan program. The bond proceeds were used for private loans for irrigation projects. At June 30, 2018, the department had a total of \$945,000 of GO public bonds and \$4,292,500 of GO private bonds outstanding for this program.

In fiscal year 2015-16 and in prior fiscal years, the department issued CST bonds for the Renewable Resource Grant and Loan program. The bond proceeds were used for public loans for irrigation, water, sewer and dam projects. At June 30, 2018, the department had a total of \$12,984,921 of CST bonds outstanding.

The department has a loan from the U.S. Bureau of Reclamation to fund the Middle Creek Dam project. The unpaid loan principal and interest during construction balance as of June 30, 2018, was \$2,033,269.

The Northern Cheyenne Tribe and the department entered into an agreement on July 1, 1994, in which the tribe agreed to loan the state up to \$11,500,000 of federal funds appropriated as part of the Northern Cheyenne Indian Reserved Water Rights Settlement. The noninterest bearing loan was used to help finance the costs of the Tongue River Dam Project. The actual amount of the loan was \$11,300,000. The outstanding loan balance at June 30, 2018, was \$5,794,872. In March 2005, the department issued CST bond to the tribe for \$9,851,282 as security for the loan. The bond, which is noninterest bearing, provides a means of repayment to the tribe in the event pledged revenues are insufficient for loan repayment.

6. Transfers-In

The Schedule of Total Revenues and Transfers-In contain the following activity in the transfers-in class:

- ◆ **State Special Revenue Fund** – This activity represents:
 - ◇ the transfer of general funds to the Water Adjudication account per 85-2-280(2), MCA;
 - ◇ the transfer of general funds to the Sage Grouse Stewardship account per 15-1-122(5), MCA;
 - ◇ the transfer of funds from the school facility and technology account to the guarantee account per the November 2017 Legislative Special Session House Bill 6;
 - ◇ the transfer of funds from the account provided for in 75-10-532 for junk vehicles to the natural resources operations state special revenue account per the 2017 Legislative Session House Bill 648;
 - ◇ the transfer of Common School Permanent Trust Fund earnings to the Guarantee Account for distribution to school districts;
 - ◇ the transfer of trust earnings from permanent trust funds to earnings reserve;
 - ◇ the transfer of grant funds and state funds from department divisions and other state agencies;
 - ◇ the movement of the liabilities for Intercap loans from the Montana Board of Investments to the debt service funds;
 - ◇ the movement of loans receivable from other funds;
 - ◇ the transfer of liability that was created when the Board of Investments (BOI) purchased a DNRC bond;
 - ◇ the transfer of recycled funds and state match in the Water Pollution Control and Drinking Water SRF Programs to make loans.
 - ◇ the transfer of federal funds from the Department of Environmental Quality for the Water Pollution Control and Drinking Water SRF Programs to make loans;
 - ◇ the transfer of funds from the trusts to administer state trust lands;
 - ◇ the transfer of funds from the Broadwater Dam debt service fund in excess of the debt service requirement to the state projects hydro earnings fund;
 - ◇ the transfer of funds from the GO Bond debt service fund in excess of the debt service requirement to the natural resources projects fund; and
- ◆ **Federal Special Revenue Fund** – This activity is comprised of the transfer in of federal grant funds from other state agencies.
- ◆ **Debt Service Fund** – This activity is comprised of
 - ◇ the movement of loans receivable from other funds;
 - ◇ the transfers from debt service reserve or other program funds, and

- ◇ the transfers between debt services funds.
- ◆ **Internal Service Fund** – This activity represents the transfers from the general fund and fire protection tax fund for base funding of the air operations.
- ◆ **Permanent Fund** – This activity represents the distribution of interest & income and the allocation of the appreciation/depreciation of the Trust Fund Investment Pool within the trust funds administered by the department.

7. Transfers-Out

The Schedule of Total Expenditures and Transfers-Out contain the following activity in the transfers-out class:

- ◆ **Conservation /Resource Development Division** – This activity represents:
 - ◇ Transfer of fund from the natural resource projects state special revenue account to the general fund per November 2017 Legislative Special Session House Bill 6;
 - ◇ transfers of natural resource projects fund for House Bill 6, Renewable Resource Grants, and House Bill 7, Reclamation and Development Grants, to other department division and state agencies;
 - ◇ SRF transfers associated with the movement of loans receivable, sweeps and interest earnings to other funds;
 - ◇ the movement of loans receivable to other funds;
 - ◇ the transfer of liability that was created when the Board of Investments (BOI) purchased a DNRC bond;
 - ◇ the transfer of funds from the GO Bond debt service fund in excess of the debt service requirement to the natural resources projects fund;
 - ◇ the transfer of the residual equity in the CST shared state special revenue account to the conservation districts state special revenue account;
 - ◇ the transfer of funds from CST Bonds debt service funds in excess of the debt service requirement to the state projects hydro earnings account; and
 - ◇ the transfers between debt service funds.
- ◆ **Directors Office** – This activity represents the transfer from the general fund to Water Resources Division.
- ◆ **Forestry/Trust Lands Division** – This activity represents:
 - ◇ the transfers from the general fund and fire protection tax fund for base funding of the air operations;
 - ◇ The transfer of funds from the trust administration account to the common school earnings reserve account.
- ◆ **Oil & Gas Conservation Division** – This activity represents the transfers of funds from the oil and gas production damage mitigation state special revenue account to the Montana Dept. of Fish, Wildlife and Parks and to the hazardous waste/CERCLA special revenue account per the 2017 Legislative Session House Bill 648.

- ◆ **Trust Funds** – This activity represents:
 - ◇ the allocation of the appreciation/depreciation of the Trust Fund Investment Pool within the trust funds administered by the department;
 - ◇ the transfer of timber revenue in excess of 18 million board feet on Common School Trust Lands to the Montana Dept. of Commerce for school technology purposes;
 - ◇ the transfer of trust earnings from permanent trust funds to earnings reserve;
 - ◇ the transfer of funds from the trusts to administer state trust lands; and
 - ◇ the distribution of earnings to the trust permanent funds and the transfer of earnings to the trust beneficiaries.
- ◆ **Water Resources Division** – This activity represents:
 - ◇ the transfer of fund from the state project hydro earnings state special revenue account to the general fund per the November 2017 Legislative Special Session House Bill 6; and
 - ◇ This activity represents the transfers of funds from the water storage state special revenue account to the ground water assessment state special revenue account per the 2017 Legislative Session House Bill 648.

8. Fire Suppression Fund Transfers and Ending Fund Equity

The department receives transfer-in revenue from the general fund to the fire suppression fund per 76-13-150(6), MCA. In fiscal year 2016-17 the department recorded revenue of \$11.4 million based on the reverted general funds in fiscal year 2015-16. However, in fiscal year 2017-18, no general fund transfer was done from the fiscal year 2016-17 reverted general funds per 76-13-150(10), MCA. In fiscal year 2017-18, the only transfer-in revenue received in the fund per the November 2017 Legislative Special Session were:

- ◆ \$14.7 million per Senate Bill 4 from the Board of Investments, and
- ◆ \$25.3 million per House Bill 6 from the general fund.

Additionally, in fiscal year 2017-18, the department made the following transfers-out of the fund per the 2017 Legislative Session:

- ◆ \$30 million per Senate Bill 261 to the general fund, and
- ◆ \$100,000 per House Bill 647 to the Office of the Commissioner of Higher Education

The ending fund equity in the fire suppression fund on June 30, 2018, was \$8.5 million.

9. Fire Suppression Expenditures

In fiscal year 2017-18, the department incurred significant fire suppression expenditures for the calendar year 2017 fire season of \$65.3 million. This resulted in significant increases in the following expenditure categories: Salaries, Hourly Wages, Other Services, Travel and Rent. In addition, Federal agency reimbursements, such as the Federal Emergency Management Agency (FEMA), US Forest Service and the Bureau of Land Management, are estimated at \$23 million.

10. SRF Program Transfers-In and Transfers-Out

In fiscal years 2016-17 and 2017-18, the SRF Drinking Water program saw increases in transfer-in revenues and transfer-out expenditures over fiscal year 2015-16. This is primarily due to the substantial increase in loans in the SRF program. In fiscal year 2015-16, the program processed \$12.5 million in loans disbursements. In fiscal year 2016-17, the program processed \$24.2 million in loan disbursements, an increase of \$11.7 million. In fiscal year 2017-18, the program processed \$34 million in loan disbursements, an increase of \$21.5 million.

In fiscal year 2015-16, the SRF Wastewater program saw decreases in transfer-in revenues and transfer-out expenditures over fiscal year 2015-16. This is primarily due to the substantial decrease in loans in the SRF program. In fiscal year 2015-16, the program processed \$76.1 million in loans disbursements. In fiscal year 2016-17, the program processed \$50.5 million in loan disbursements, a decrease of \$25.6 million. In fiscal year 2017-18, the program processed \$38.5 million in loan disbursements, a decrease of \$37.6 million.

11. Unspent Budget Authority

The table below summarizes significant unspent budget authority by program. For fiscal year 2016-17, most amounts are related to biennial and continuing appropriations and the budget authority extends to fiscal year 2017-18.

Unspent Budget Authority

	FY 2016-17	FY 2017-18
Conservation & Resource Development Division		
Bond Proceeds (various funds)	\$2,637,000	\$1,987,000
House Bill 8 CST Bonds	\$15,809,000	\$0
Natural Resources Projects	\$495,000	\$9,391,000
Sage Grouse Stewardship	\$8,500,000	\$1,800,000
SRF Federal Authority	\$5,270,000	\$5,701,000
Treasure State Endowment	\$1,485,000	\$5,698,000
Water Resources Division		
CSKT MOU*	\$2,624,000	\$2,331,000
Blackfeet Mitigation	\$14,500,000	\$14,500,000
State Projects Hydro Earnings	\$2,275,000	\$643,000
Water Project Loans	\$1,066,000	\$1,031,000
Water FEMA Grants	\$1,034,000	\$2,251,000
Forestry/Trust Lands Division		
Contract Timber Harvesting	\$1,000,000	\$1,000,000
TLMD Trust Administration	\$1,003,000	\$732,000
Fire Suppression Fund	\$0	\$11,000,000
Federal Grant Funds	\$8,302,000	\$9,588,000

* CSKT MOU – Confederated Salish and Kootenai Tribes Memorandum of Understanding

12. Related Party Transaction

Per Title 85, Chapter 1, part 6, MCA, Renewable Resource Grant and Loan Program, the department is eligible to issue GO bonds for the purpose of making private sale loans. DNRC has applied and received “recycled loan funds” from the SRF program for the non-point source private loan program. The loans are GO private sale bonds. The balances for loans in repayment for FY 2017 and FY 2018 were \$5,230,500 and \$4,292,500, respectively. The loans have interest rates ranging from 3% to 4.3% and are repaid over 15 years. These loans are presented as Advances to Other Funds on the balance sheets.

13. Land Banking

The Land Banking program sells land to the public and puts the proceeds in a Land Banking Trust Fund. The combined funds from multiple sales can then be used to purchase parcels which produce a higher level of income than the lands sold. This results in a greater income to the trust beneficiaries. In fiscal year 2016-17, approximately \$15.2 million of state trust land was sold and \$1.3 million was purchased. In fiscal year 2017-18, approximately \$2.27 million of state trust land was sold and \$16 million was purchased.

14. Permanent Trust Funds

In fiscal years 2016-17 and 2017-18, the permanent trust funds saw decreases in revenues and expenditures over fiscal year 2015-16. This is primarily due to the depreciation of the trust fund bond pool investment of approximately \$38.6 million and \$42.8 million, respectively.

Additionally, in fiscal year 2016-17, the permanent funds show negative prior year revenue of \$17 million due to an error recording the accounting entries to reverse the unrealized investment earnings.

15. Hydro Power Site Lease-Revenue Under Protest

In fiscal year 2016-17, Avista, due to a dispute, invoked paragraph 4.7 of the Hydropower Site Lease between the DNRC and Avista. This allows Avista to make rental payments under protest into an escrow account. Avista established a joint escrow account with the State of Montana at U.S. Bank NA. As of June 30, 2018, Avista deposited \$9.5 million, which represents their 2017 and 2018 lease payments, into the account.

Report on Internal Control and Compliance

LEGISLATIVE AUDIT DIVISION

Angus Maciver, Legislative Auditor
Deborah F. Butler, Legal Counsel



B-1
Deputy Legislative Auditors
Cindy Jorgenson
Joe Murray

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL SCHEDULES PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

The Legislative Audit Committee
of the Montana State Legislature:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the Schedules of Changes in Fund Equity & Property Held in Trust, Schedules of Total Revenues & Transfers-In, and Schedules of Total Expenditures & Transfers-Out of the Department of Natural Resources and Conservation for each of the fiscal years ended June 30, 2018, and 2017, and the related notes to the financial schedules, and have issued our report thereon dated October 3, 2018. Our report includes a qualified opinion on the Schedule of Changes in Fund Equity & Property Held in Trust, Schedule of Total Revenues & Transfers-In, and Schedule of Total Expenditures & Transfers-Out for the fiscal year ended June 30, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial schedules, we considered the department's internal control over financial reporting to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial schedules, but not for the purpose of expressing an opinion on the effectiveness of the department's internal control. Accordingly, we do not express an opinion on the effectiveness of the department's internal control.

A *deficiency in internal control* 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 and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial schedules will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal controls was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified.

- ◆ We identified a deficiency in internal control over permanent fund transactions that we consider to be a material weakness. See the finding and recommendation starting on page 7 for a description of this material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the department's financial schedules are free from 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 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 response to the findings identified in our audit are described on page C-1 of this report. The department's response was not subjected to the auditing procedures applied in the audit of the financial schedules and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the department's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the department's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Respectfully submitted,

/s/ Cindy Jorgenson

Cindy Jorgenson, CPA
Deputy Legislative Auditor
Helena, MT

October 3, 2018

DEPARTMENT OF
NATURAL RESOURCES
AND CONSERVATION

DEPARTMENT RESPONSE

DEPARTMENT OF NATURAL RESOURCES
AND CONSERVATION



STEVE BULLOCK, GOVERNOR

1539 ELEVENTH AVENUE

STATE OF MONTANA

DIRECTOR'S OFFICE (406) 444-2074
FAX: (406) 444-2684PO BOX 201601
HELENA, MONTANA 59620-1601

November 1, 2018

Angus Maciver
Legislative Auditor
Legislative Audit Division
P O Box 201705
Helena, MT 59620-1705

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LEGISLATIVE AUDIT DIV.

**RE: DNRC Written Response to the Legislative Audit Division Financial-
Compliance Audit for the Two Fiscal Years Ended June 30, 2018**

RECOMMENDATION #1

We recommend the Department of Natural Resources and Conservation monitor, and continue to update, internal controls for Land Grant accounting entries:

Concur. The department will implement additional internal controls for Land Grant accounting entries.

RECOMMENDATION #2

We recommend the Department of Natural Resources and Conservation segregate accounting duties related to the approval and review of accounting transactions involving the classification of assets related to the State Revolving Fund and Blackfeet Mitigation Funds.

Concur. The department will implement additional internal controls in the review and approval of accounting transactions involving the classification of assets related to the State Revolving Fund and Blackfeet Mitigation Funds.

RECOMMENDATION #3

We recommend the Department of Natural Resources and Conservation implement controls to reduce temporary increases in Procard limits when the period requiring the increase is over.

Concur. The department will implement controls to reduce temporary increases in Procard limits when the period requiring the increase is over.

RECOMMENDATION #4

We recommend the Department of Natural Resources and Conservation develop controls to monitor and facilitate compliance with reporting requirements in state law and ensure completeness of fundraising revenue for the Flathead Basin Commission.

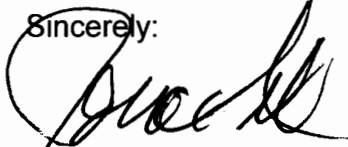
Concur. The department will develop controls to monitor and facilitate compliance with reporting requirements in state law and ensure completeness of fundraising revenue for the Flathead Basin Commission.

RECOMMENDATION #5

We recommend the Department of Natural Resources and Conservation consistently implement controls over employee awards.

Concur. The department will consistently implement controls over employee awards.

Sincerely:

A handwritten signature in black ink, appearing to read "John E. Tubbs". The signature is written in a cursive style with a large initial "J" and "T".

John E. Tubbs
Director