



**Department of the Interior  
Office of Inspector General**

# **AUDIT REPORT**

**U.S. Fish and Wildlife Service  
Federal Assistance Grants  
Awarded to the State of Minnesota,  
Department of Natural Resources,  
Division of Fish and Wildlife,  
From July 1, 2002, Through June 30, 2004**

**Report No. R-GR-FWS-0018-2005      February 2007**



# United States Department of the Interior

## OFFICE OF INSPECTOR GENERAL

12030 Sunrise Valley Drive, Suite 230  
Reston, Virginia 20191

February 1, 2007

### Memorandum

To: Director  
U.S. Fish and Wildlife Service

From: Christina M. Bruner *Christina M. Bruner*  
Director of External Audits

Subject: Audit Report on the U.S. Fish and Wildlife Service Federal Assistance Grants  
Awarded to the State of Minnesota, Department of Natural Resources,  
Division of Fish and Wildlife, From July 1, 2002, Through June 30, 2004  
(No. R-GR-FWS-0018-2005)

This audit report presents the results of our audit of costs incurred by the State of Minnesota (State), Department of Natural Resources (Department), Division of Fish and Wildlife (Division). The Division incurred the costs under Federal Assistance grants awarded by the U.S. Fish and Wildlife Service (FWS). The audit included total reported outlays of approximately \$60.1 million on FWS grants that were open during the State fiscal years (SFYs) ended June 30 of 2003 and 2004 (see Appendix 1). The audit also evaluated Department compliance with applicable laws, regulations, and FWS guidelines, including those related to the collection and use of State hunting and fishing license revenues and the reporting of program income.

We found that the Department complied, in general, with applicable grant accounting and regulatory requirements. We identified \$505,600 of unreported program income and numerous barter transactions that were not reflected in the financial status reports. We also identified problems in the areas of direct costs, indirect costs, and assent legislation.

We provided a draft of the report to FWS and the Department for response. This report summarizes Department and FWS Region 3 responses after each recommendation, as well as our comments on the responses. We list the status of the recommendations in Appendix 3.

Please respond in writing to the findings and recommendations included in this report by May 2, 2007. Your response should include information on actions taken or planned, targeted completion dates, and titles of officials responsible for implementation.

If you have any questions regarding this report, please contact the audit team leader, Mr. Larry Kopas at 703-487-5358, or me at 703-487-5345.

cc: Regional Director, FWS Region 3, U.S. Fish and Wildlife Service

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## Introduction

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### Background

The Pittman-Robertson Wildlife Restoration Act and the Dingell-Johnson Sport Fish Restoration Act (Acts),<sup>1</sup> authorize FWS to provide Federal Assistance grants to states to enhance their sport fish and wildlife programs. The Acts provide for FWS to reimburse the states up to 75 percent of the eligible costs incurred under the grants. They also specify that state hunting and fishing license revenues cannot be used for any purpose other than the administration of state fish and wildlife agencies.

### Objectives

The objectives of our audit were to determine whether the Department:

- claimed the costs incurred under Federal Assistance grants in accordance with the Acts and related regulations, FWS guidelines, and the grant agreements;
- used State hunting and fishing license revenues solely for fish and wildlife program activities; and
- reported and used program income in accordance with federal regulations.

### Scope

The audit work included total reported outlays of approximately \$60.1 million on 34 FWS grants that were open during SFYs 2003 and 2004 (see Appendix 1). We performed our audit at the Department headquarters in St. Paul, Minnesota, and visited one regional office, seven area offices, two fish hatcheries, three water access sites, one fish management area, and one wildlife management area (see Appendix 2). We performed this audit to supplement, not replace, the audits required by the Single Audit Act of 1984, as amended, and the by Office of Management and Budget Circular A-133.

### Methodology

We performed our audit in accordance with the “Government Auditing Standards” issued by the Comptroller General of the United States. Accordingly, we tested records and conducted other auditing procedures as we considered necessary under the circumstances. Our tests and procedures included:

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<sup>1</sup> As amended 16 U.S.C. §§ 669 and 777, respectively.

- examining the evidence that supports selected expenditures charged to the grants by the Division;
- interviewing Division employees to ensure that personnel costs charged to the grants were supportable;
- reviewing transactions and supporting documentation related to purchases, other direct costs, drawdowns for reimbursements, in-kind contributions, and program income;
- conducting site visits to review equipment and other property; and
- determining whether the Department used fishing license revenues solely for sport fish and wildlife program purposes.

To the extent possible, we relied on the work of the Office of Legislative Auditor, which performed the SFYs 2003 and 2004 single audits, to avoid duplication of audit effort.

We also identified internal controls over transactions recorded in the labor and license fee accounting systems and tested their operation and reliability. Based on the results of initial assessments, we assigned a level of risk to these systems and selected a judgmental sample of transactions for testing. We did not project the results of tests to the total population of recorded transactions nor did we evaluate the economy, efficiency, or effectiveness of the Department operations.

## **Prior Audit Coverage**

On November 12, 2002, we issued Advisory Report No. 2003-E-0004 “Costs Claimed by the State of Minnesota, Department of Natural Resources, under Federal Aid Grants from the U.S. Fish and Wildlife Service from July 1, 1997 through June 30, 1999”. We followed up on all recommendations and determined they were resolved and implemented.

In addition, the Office of Legislative Auditor issued single audit reports for SFYs 2003 and 2004. The Sport Fish Restoration and Wildlife Restoration Programs were not selected for compliance testing in either 2003 or 2004. As such, the single audits did not contain any findings that would directly impact the Department’s FWS Federal Assistance grants.

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## Results of Audit

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### Audit Summary

We found that the Department complied, in general, with grant agreement provisions and requirements of the Acts and regulations. However, we identified the findings listed below. We discuss the findings in more detail in the Findings and Recommendations Section.

**Unreported Program Income.** The Department had at least \$505,600 in unreported program income from activities on lands managed with Federal Assistance funds as well as from barter transactions.

**Incorrect Direct Costs Charged.** Certain direct costs charged to Federal Assistance grants in SFY2004 were based on cost information that was both outdated and included duplicate, misclassified, and unsupported costs.

**Noncompliance With Assent Legislation.** Minnesota's assent legislation includes a provision that allows for the potential diversion of license revenues to non-fish and wildlife activities.

**Compliance With the 3 Percent Limitation Not Ensured.** The Department had not adopted procedures to ensure the Department limits allocations for State central services to 3 percent of the State's annual Federal Assistance apportionments.

### Findings and Recommendations

#### A. Unreported Program Income

The Department did not report all program income generated on lands within the wildlife management areas (WMAs) that were managed and maintained with Federal Assistance funds under grants W-65-D-3, W-65-D-4, and W-65-D-5.

Program income is gross income received by a grantee directly generated by a grant-supported activity; it includes income from services performed and the sale of commodities (43 C.F.R. § 12.65). Part 12.65(g) requires program income to be deducted from total grant costs to determine the net costs on which the federal share is based. With FWS approval, program income may be added to the project funds to further implement eligible program projects or be used to meet the cost sharing or matching requirement.

The Department identified \$505,600 as unreported income from various activities on WMA lands, including timber sales, crop leases, and the sale of sand and gravel permits. The Division program consultant, who is responsible for reporting program income, told us that FWS Region 3 officials instructed him to exclude income from activities on lands not acquired with Federal Assistance funds. FWS Director's Order No. 168, however,

defines program income as income generated on lands both purchased and managed with Federal Assistance funds.

In October 2005, we notified FWS and Department officials of this issue. The Division subsequently (1) adopted procedures to report program income from relevant WMAs and (2) submitted revised financial status reports (SF-269s) properly identifying the \$505,600 as undisbursed program income for the three grants. The Department's Federal Assistance Coordinator told us the Department plans to seek FWS approval to apply the program income against expenditures in excess of the grant awards.

We also found the Department did not report program income from barter transactions. The Division issues about 420 contracts annually in which farmers, in exchange for use of tillable acreage on the WMAs and in lieu of lease payments, agree to leave a portion of their crop in the field for the benefit of wildlife. The Division's program consultant told us he was unaware barter arrangements should be treated as program income. He also stated he did not know how to value and report the income on the SF-269s.

We believe the value of crops received in lieu of lease payments should be reported as program income. The value of the lease payments that the Department did not receive because of the barter arrangement should also be included in the reported outlays on the SF-269. In the future, these types of barter arrangements should be identified in the grant application, and the appropriate accounting and reporting should be identified in the grant agreement.

## **Recommendations**

We recommend that FWS:

1. ensure grant expenditures over the grant award amounts are sufficient to offset the unreported program income;
2. coordinate with the Department to establish procedures for (a) identifying the barter farming arrangements, including anticipated program income, in the grant application and (b) reporting the value of the crops received as program income on the SF- 269; and
3. resolve the issue of the unreported program income from the barter farming arrangements that occurred during the audit period.

## **Department Response**

Department officials stated that they concurred with recommendation 1. They identified excess costs sufficient to offset the \$505,600 in unreported program income and amended the SF-269s for grants W-65-D-3, W-65-D-4, and W-65-D-5 to show the adjustment.

The Department does not concur with recommendations 2 and 3 concerning the identification, reporting and resolution of income from its barter farming arrangements. Department officials stated the federal regulations (Title 43 § 12.65(b)) do not specifically mention barter farming arrangements as program income, and that state accounting practices do not require reporting of barter arrangements. They further stated that the Department proposes to remove from the grant agreement all activities associated with cooperative farming and bartering agreements and seek FWS approval to exempt their barter income from federal reporting requirements.

### **FWS Response**

The FWS Region 3 did not comment on Finding A's recommendations.

### **OIG Comments**

In response to the Department's disagreement with recommendations 2 and 3, we note that under FWS Director's Order 168, Exhibit 1, program income includes income generated during the grant period from the harvest of assets—such as timber or hay—that contribute to grant objectives on lands purchased or managed with Federal Assistance funds. The Division agreed to allow farmers to use tillable acreage on WMAs in exchange for leaving crops, which are assets, for wildlife. In addition, we note that the regulations cited in the finding require grantees to account for program income, although the FWS may approve various methods of doing so.

The FWS did not comment on the three recommendations. We therefore consider the recommendations unresolved. FWS should provide a response to the recommendations indicating concurrence or non-concurrence. If the FWS concurs, officials should provide a plan that identifies the actions taken or planned to implement the recommendations, targeted completion date(s), the title of official(s) responsible for implementation, and verification that FWS officials reviewed and approved of actions taken or planned by the State. If FWS does not concur, officials should provide the reasons for the non-concurrence.

## **B. Incorrect Direct Rates Charged**

In SFY2004, the Division developed a direct cost rate that the Department used for fringe benefit and administrative costs. The rate did not comply with applicable regulations because it was based on cost information which was both outdated and included duplicate, misclassified, and unsupported costs.

Title 2 C.F.R. § 225, Appendix B.8, provides that compensation for personnel services is allowable if costs are reasonable and supported by adequate documentation. In addition, Title 43 C.F.R. § 12.63(a) provides that where a funding period is specified, a grantee may charge to the award only costs obligated during the funding period.

The Division based its direct cost rate for SFY2004 on SFY2002 Division salaries, including fringe benefit and administrative costs for that year. The Division should have calculated the rate using SFY2004 cost data. Additionally, the SFY2002 fringe benefit costs used in the direct rate calculation included unallowable costs consisting of duplicate, misclassified, and unsupported costs. Eliminating the unallowable costs would reduce the fringe benefit cost rate from 23.85 percent to 20.01 percent and would reduce the costs incurred under the grants by \$664,621.

We were unable to assign the \$664,621 of costs to specific grants or calculate the total questioned costs because of the numerous adjustments necessary to calculate the revised direct rate charges. In addition, the amount of actual SFY2004 fringe benefit costs and administrative costs would need to be compared with the SFY2002 costs used by the Division to determine if additional adjustments were needed.

We believe that the Division did not properly calculate the direct rate because the calculations were not reviewed at an adequate supervisory level. Rather, a single individual prepares and applies the direct rate calculation each year without subsequent review. In addition, there is no process in place to compare the reasonableness of the direct rate calculations to the actual time spent by Division staff working on the Federal Assistance grants.

### **Recommendations**

We recommend that FWS require the Department to:

1. determine the proper amount of fringe benefit costs and administrative costs, recalculate the direct rates applicable to Federal Assistance grant labor costs for SFYs 2003 and 2004, and resolve any overcharges to Federal Assistance grants;
2. use only current year fringe benefit costs and administrative costs in future direct rate calculations, including SFYs 2005 and 2006, to avoid the need for subsequent adjustments; and
3. establish procedures to assure adequate review and approval of the Division's direct rate calculations that are applied to future Federal Assistance grants.

### **Department Response**

The Department concurred with the three recommendations. To address the recommendations, Department officials indicated they:

1. recalculated the rates used during FYs 2003 and 2004 and applied those rates to the relevant grants;



2. documented a new procedure for FY2006 and beyond to calculate and apply the direct rate on a current pay period basis;
3. included the new procedure in a December 2005 update to its Federal Assistance Fiscal Policies Manual; and
4. requested that the Department's Office of Management and Budget Services review and approval the new direct rates.

The Department determined that the overcharges found during FYs 2003 and 2004 were offset by excess eligible grant expenditures, and is requesting that FWS review and approve the use of the excess costs to address the overcharges.

### **FWS Response**

The FWS Region 3 concurred with the recommendations, and will address the findings in the Corrective Action Plan.

### **OIG Comments**

FWS management concurs with the recommendations and the Department indicated it has taken action to address the recommendations, but additional information is needed in the corrective action plan verifying that FWS reviewed and approved the actions completed or planned by the Department. The plan should also include the actions taken or planned, targeted completion dates, and titles of officials responsible for implementation.

## **C. Noncompliance With Assent Legislation**

Minnesota's assent legislation includes a provision that allows for the potential diversion of hunting and fishing license revenues to non-fish and wildlife activities. Although the Minnesota State Game and Fish Code (Code) Chapters 97A and 97B specify purposes for which the game and fish fund can be used, the Code does not specifically prohibit the use of funds for purposes other than the administration of the fish and wildlife agency.

Title 50 C.F.R. §§ 80.3 and 80.4 require that before any monies are apportioned to a state, the state must assent to the provisions of the Acts. The state must pass laws that prohibit the use of license fees paid by sport fishermen for any purpose other than the administration of the state fish and wildlife agency.

In November 2002, we reported that a provision in the State's Code could result in the diversion of license revenues. Chapter 97A.065(b) 'Dedication of certain receipts' stated that "The Commissioner must reimburse a county, from the game and fish fund, for the cost of keeping prisoners prosecuted for violations of the game and fish laws....." To correct this deficiency, the legislation was revised to state that the commissioner may, rather than must, reimburse a county from the game and fish fund.

Although the Division has not used the game and fish fund since 1993 to reimburse counties for keeping prisoners prosecuted for game and fish violations, potential exists for such use of game and fish funds. Such use of game and fish funds would be a diversion of license revenues and would result in the State becoming ineligible to participate in the Federal Assistance program.

### **Recommendation**

We recommend that FWS require the Department to propose legislation to eliminate the Code's provision allowing the commissioner to use the game and fish fund to reimburse counties for the cost of keeping prisoners prosecuted for violating game and fish laws.

### **Department Response**

The Department concurred with the recommendation, and petitioned the Minnesota Legislature to remove the Code's provision that creates the potential for a diversion of license revenue. The Department submitted documentation indicating that the Minnesota Legislature amended the relevant statute to strike the provision.

### **FWS Response**

The FWS Region 3 concurred with the recommendation, and will address the findings in the Corrective Action Plan.

### **OIG Comments**

FWS management concurs with the recommendation and the Department indicated it has taken action to address the recommendation, but additional information is needed in the corrective action plan verifying that FWS reviewed and approved the actions completed by the Department.

## **D. Compliance With 3 Percent Limitation Not Ensured**

States allocate administrative costs for state-provided central services as an indirect cost across multiple grants and programs. Both the Sport Fish Restoration and the Wildlife Restoration Acts limit indirect costs that states can allocate for state central services to Federal Assistance grants. The Department's SFYs 2003 and 2004 indirect cost rate proposals did not include an analysis to determine whether the costs of State central services outside the Department exceeded the limitation.

The Acts' limitation on indirect costs has been codified in 50 C.F.R. § 80.15(e), which requires administrative costs in the form of indirect costs for state central services to follow an approved cost allocation plan and not to exceed 3 percent of the annual Federal Assistance apportionment in any year. Additionally, Title 2 C.F.R. § 225, Appendix E, requires government entities to prepare an indirect cost rate proposal using actual cost data from prior years. Section C.4 (b) requires states to request a special rate when

Federal statutes restrict the reimbursement of certain indirect costs. The analysis to determine whether a state will exceed the 3 percent limitation should be performed before they negotiate the indirect cost rate.

Each year, the Department submits an indirect cost proposal to the U.S. Department of Interior's National Business Center (NBC) for each division in the Department. The Department applies the negotiated indirect cost rates to the Division's federal grants, subject to statute. The Department's accountant, who prepared the indirect cost proposals, told us she was aware of the required limitation on central services but she relied on NBC to ensure compliance with the limitation. She also told us NBC did not begin requesting verification of the 3 percent limitation from the Department until January 2004, for its SFY2005 indirect cost proposal submission.

NBC incorrectly based its analysis of the 3 percent limitation for SFYs 2003 and 2004 on the Division's annual data on revenue rather than expenditures. NBC's Indirect Cost Coordinator told us they used revenue data because the Department's financial statements did not identify expenditures at the Division level. Cost data at the Division level is necessary to ensure Division compliance with the 3 percent limitation.

The Division's accountant later performed an analysis of the central services costs included in the indirect cost rates approved for SFYs 2003 and 2004. Although the analysis determined the Department did not recover more than the 3 percent limit, the Division came within \$21,000 of the limit during SFY2004 because the amount of costs allocated to the Division was almost double that of the prior year.

### **Recommendation**

We recommend that FWS require the Department to:

1. establish policies and procedures requiring that before an indirect cost rate is negotiated, an analysis be performed of central services costs included in the indirect cost rate proposal to ensure compliance with the 3 percent limitation; and
2. apply for and receive a restricted rate if analysis shows the 3 percent limitation will be exceeded.

### **Department Response**

The Department concurred with both recommendations, and plans to rewrite its policy and procedure manual for calculating the federal indirect cost rate. The revised manual will include the procedure for completing the 3 percent limitation analysis and a requirement to apply for a restricted rate if the 3 percent limitation is exceeded.

**FWS Response**

The FWS Region 3 concurred with the recommendation, and will address the findings in the Corrective Action Plan.

**OIG Comments**

FWS management concurred with the recommendations and the Department indicated it has taken steps to address the recommendations, but additional information is needed in the corrective action plan verifying that FWS reviewed and approved the actions completed or planned by the Department. The plan should also include the actions taken or planned, the targeted completion dates, and titles of officials responsible for implementation.

## Appendix 1

**MINNESOTA DEPARTMENT OF NATURAL RESOURCES  
FINANCIAL SUMMARY OF REVIEW COVERAGE  
JULY 1, 2002 THROUGH JUNE 30, 2004**

<b>Grant Number</b>	<b>Grant Amount</b>	<b>Total Outlays</b>
F-2-L-60	\$965,000	\$286,124
F-2-L-61	1,499,000	-
F-26-R-34	1,386,321	879,793
F-26-R-35	1,488,850	1,191,391
F-26-R-36	1,329,895	1,005,029
F-29-R(P)-22	7,984,200	6,102,710
F-29-R(P)-23	7,865,900	8,112,365
F-29-R(P)-24	8,079,400	1,910,291
F-32-D(S)-17	5,581,200	5,440,752
F-32-D(S)-18	4,785,660	5,202,821
F-37-E-12	240,000	172,352
F-37-E-13	276,749	569,293
F-37-E-14	451,569	297,464
FW-4-D-68	800,000	737,738
FW-11-C-14	251,053	20,193
FW-11-C-15	308,115	139,362
FW-13-T(SI)-12	965,000	447,355
FW-13-T(SI)-13	1,450,000	1,664,518
FW-13-T(SI)-14	1,127,000	1,166,805
W-27-L-116	1,016,310	337,593
W-65-D-3	7,333,000	2,343,867
W-65-D-4	4,505,000	6,734,882
W-65-D-5	4,622,000	2,969,977
W-66-M-3	1,258,000	1,130,048
W-66-M-4	1,080,000	305,753
W-66-M-5	1,800,000	314,389
W-67-T-5	1,845,161	1,911,775
W-67-T-6	1,693,701	1,668,405
W-68-D-5	1,608,000	2,672,696
W-68-D-6	1,653,960	2,955,620
W-69-S-5	383,600	488,811
W-69-S-6	394,600	387,255
W-70-E-1	461,463	252,468
W-70-E-2	388,313	266,711
	<u>\$76,878,020</u>	<u>\$60,086,606</u>

**MINNESOTA DEPARTMENT OF NATURAL RESOURCES  
SITES VISITED**

**Headquarters**

Division of Fisheries and Wildlife, St. Paul, MN

**Wildlife Section**

Grand Rapids Regional Headquarters

Cloquet Area Office

Detroit Lakes Area Office

Fergus Falls Area Office

Glenwood Area Office

Grand Rapids Area Office

Park Rapids Area Office

**Wildlife Management Area**

Bowstring Deer Yard WMA

**Fisheries Section**

Detroit Lakes Area Office

Duluth Area Office

Fergus Falls Area Office

Glenwood Area Office

Grand Rapids Area Office

Park Rapids Area Office

**Fish Hatcheries**

French River Coldwater Hatchery

Otter Tail Lake Hatchery

**Fish Management Area**

Jewel Lake FMA

**Water Access Sites**

Marion Lake WAS

Pelican Lake WAS

Pleasant Lake WAS

## Appendix 3

### MINNESOTA DEPARTMENT OF NATURAL RESOURCES STATUS OF AUDIT FINDINGS AND RECOMMENDATIONS

Recommendations	Status	Action Required
A.1, A.2, A.3	Unresolved.	FWS should provide a response to the recommendations indicating concurrence or non-concurrence. If the FWS concurs, provide a plan that identifies the actions taken or planned to implement the recommendations, targeted completion date(s), the title of official(s) responsible for implementation, and verification that FWS officials reviewed and approved of actions taken or planned by the State. If FWS does not concur, provide the reasons for the non-concurrence. We will refer recommendations not resolved and/or implemented at the end of 90 days (after May 2, 2007) to the Assistant Secretary for Policy, Management and Budget for resolution and/or tracking of implementation.
B.1, B.2, B.3, C, D.1 and D.2	FWS concurred with the recommendations, but additional information is needed.	Provide a corrective action plan that identifies the actions taken or planned to resolve and implement the recommendations. The plan should also include the targeted completion date and the titles of official(s) responsible for implementation of each recommendation. We will refer any recommendations that are not implemented at the end of 90 days (after May 2, 2007) to the Assistant Secretary for Policy, Management and Budget for resolution and/or tracking of implementation.

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