

**STATE OF ILLINOIS
DEPARTMENT OF NATURAL RESOURCES**

FINANCIAL AUDIT OF CAPITAL ASSET ACCOUNT
June 30, 2007

Performed as Special Assistant Auditors for
The Auditor General, State of Illinois

STATE OF ILLINOIS
DEPARTMENT OF NATURAL RESOURCES
FINANCIAL AUDIT OF CAPITAL ASSET ACCOUNT

June 30, 2007

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**STATE OF ILLINOIS
DEPARTMENT OF NATURAL RESOURCES**

AGENCY OFFICIALS

Sam Flood	Director (Interim)
Leslie Sgro	Deputy Director
Deborah Stone	Deputy Director
Ellen King-Pietrzak	Director of Office of Fiscal Management
J. J. Pohlman	Director of Office of Administration
Mike Conlin	Director of Office of Resource Conservation
Tom Flattery	Director of Office of Realty and Environmental Planning
Gary Clark	Director of Office of Water Resources
Joe Angleton	Director of Office of Mines and Minerals
John Evans	Director of Office of Architects, Engineering & Grants
Tony Mayville	Director of Office of Land Management
Rafael Gutierrez	Director of Office of Law Enforcement
Kristin Dicenso	Director of Office of Public Services
Bob Ruff	Director of Special Events, Programs & Promotions
Damon Stotts	Director of Office of Scientific Research and Analysis

Department office is located at:

One Natural Resources Way
Springfield, Illinois 62702-1271

**STATE OF ILLINOIS
DEPARTMENT OF NATURAL RESOURCES**

FINANCIAL SCHEDULE REPORT

SUMMARY

The audit of the accompanying Schedule of Capital Assets of the State of Illinois, Department of Natural Resources was performed by Sikich LLP.

Based on their audit, the auditors expressed an unqualified opinion on the Department's Schedule of Capital Assets.

SUMMARY OF FINDINGS

The auditors identified matters involving the Department's internal control over financial reporting that they considered to be significant deficiencies. The significant deficiencies are described in the accompanying Schedule of Findings on pages 13-15 of this report, as finding 07-1, inadequate controls over the calculation and submission of capital asset information for GAAP reporting purposes. The auditors also consider finding 07-1 to be a material weakness.

EXIT CONFERENCE

The response to the recommendation was provided by Ellen King-Pietrzak, Director of Office of Fiscal Management in a letter dated January 8, 2008.

The Department waived a formal exit conference.



INDEPENDENT AUDITORS' REPORT

Honorable William G. Holland
Auditor General
State of Illinois

As Special Assistant Auditors for the Auditor General, we have audited the accompanying Schedule of Capital Assets of the State of Illinois, Department of Natural Resources as of June 30, 2007. This schedule is the responsibility of the State of Illinois, Department of Natural Resources' management. Our responsibility is to express an opinion on this schedule 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 Schedule of Capital Assets is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the schedule. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 2, the schedule presents only the Capital Asset Account and does not purport to, and does not, present fairly the financial position of the State of Illinois, Department of Natural Resources as of June 30, 2007, and its changes in financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the Schedule of Capital Assets referred to above presents fairly, in all material respects, the Capital Asset Account of the State of Illinois, Department of Natural Resources, as of June 30, 2007 in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated January 8, 2008 on our consideration of the State of Illinois, Department of Natural Resources' internal control over financial reporting of the Capital Asset Account and on our tests of the State of Illinois, Department of Natural Resources compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters as they relate to the Capital Asset Account. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the Schedule of Capital Assets of the State of Illinois, Department of Natural Resources. The accompanying Schedule of Changes in Capital Assets is presented for the purpose of additional analysis and is not a required part of the Schedule of Capital Assets. The Schedule of Changes in Capital Assets has been subjected to the auditing procedures applied in the audit of the Schedule of Capital Assets and, in our opinion, is fairly stated in all material respects in relation to the Schedule of Capital Assets taken as a whole.

This report is intended solely for the information and use of the Auditor General, the General Assembly, the Legislative Audit Commission, the Governor, the Comptroller, and agency management, and is not intended to be and should not be used by anyone other than these specified parties.

Delich LLP

Springfield, Illinois
January 8, 2008

**STATE OF ILLINOIS
DEPARTMENT OF NATURAL RESOURCES**

Schedule of Changes in Capital Assets

**For the Year Ended June 30, 2007
(expressed in thousands)**

	<u>Balance At June 30, 2006</u>	<u>Additions</u>	<u>Deletions</u>	<u>Net Transfers</u>	<u>Balance At June 30, 2007</u>
Capital Assets not being depreciated:					
Land and land improvements	\$ 329,460	\$ 25,424	\$ 841	\$ 575	\$ 354,618
Total Capital Assets not being depreciated:	<u>329,460</u>	<u>25,424</u>	<u>841</u>	<u>575</u>	<u>354,618</u>
Capital Assets being depreciated:					
Site improvements	347,995	1,660	-	55,778	405,433
Building and building improvements	303,830	3,706	-	(47,572)	259,964
Infrastructure	40,614	3,429	-	569	44,612
Equipment	74,546	1,308	770	(2,464)	72,620
Capital leases - equipment	20	6	-	-	26
Total Capital Assets being depreciated:	<u>767,005</u>	<u>10,109</u>	<u>770</u>	<u>6,311</u>	<u>782,655</u>
Less Accumulated Depreciation for:					
Site improvements	149,800	11,068	-	19,613	180,481
Building and building improvements	111,874	8,611	-	(19,613)	100,872
Infrastructure	22,641	1,014	-	-	23,655
Equipment	58,637	4,079	725	(2,165)	59,826
Capital leases - equipment	3	6	-	-	9
Total Accumulated Depreciation	<u>342,955</u>	<u>24,778</u>	<u>725</u>	<u>(2,165)</u>	<u>364,843</u>
Total Capital Assets being depreciated, net	<u>424,050</u>	<u>(14,669)</u>	<u>45</u>	<u>8,476</u>	<u>417,812</u>
Total Capital Assets, net	<u>\$ 753,510</u>	<u>\$ 10,755</u>	<u>\$ 886</u>	<u>\$ 9,051</u>	<u>\$ 772,430</u>

See accompanying Independent Auditor's Report.

**STATE OF ILLINOIS
DEPARTMENT OF NATURAL RESOURCES
NOTES TO SCHEDULE OF CAPITAL ASSETS**

June 30, 2007

1. DESCRIPTION OF CAPITAL ASSET ACCOUNT

The State of Illinois, Department of Natural Resources (the Department) maintains a Capital Asset Account. Capital Assets include infrastructure, land and land improvements, site improvements, buildings, building improvements, equipment, and all other tangible assets that are used in operations and that have expected useful lives extending beyond a single reporting period.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Schedule of Capital Assets maintained by the Department has been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP), as prescribed by the Governmental Accounting Standards Board (GASB). To facilitate the understanding of data included in the schedule, summarized below are the more significant accounting policies.

(a) Reporting Entity

As defined by GAAP, the financial reporting entity consists of a primary government, as well as its component units, which are legally separate organizations for which elected officials of the primary government are financially accountable. Financial accountability is defined as:

- (1) Appointment of a voting majority of the component unit's board and either (a) the primary government's ability to impose its will, or (b) the possibility that the component unit will provide a financial benefit to or impose a financial burden on the primary government; or
- (2) Fiscal dependency on the primary government.

Based upon the required criteria, the capital asset account does not have component units, nor is it a component unit of any other entity. However, because the Capital Asset Account is not legally separate from the State of Illinois (State), it is included in the financial statements of the State. The State of Illinois' Comprehensive Annual Financial Report may be obtained by writing to the State Comptroller's Office, Financial Reporting Department, 325 West Adams Street, Springfield, Illinois, 62704-1871.

STATE OF ILLINOIS
DEPARTMENT OF NATURAL RESOURCES
NOTES TO SCHEDULE OF CAPITAL ASSETS – Continued

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

The schedule presents only the capital assets administered by the State of Illinois, Department of Natural Resources and does not purport to, and does not, present fairly the financial position of the State of Illinois, Department of Natural Resources as of June 30, 2007, and changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

(b) Basis of Presentation

The Capital Asset Account balances are reported in the State of Illinois' Comprehensive Annual Financial Report. For its reporting purposes, the Department has presented the Schedule of Capital Assets using a columnar format that presents capital assets, net of accumulated depreciation, as of June 30, 2007.

(c) Basis of Accounting

The Capital Asset Account is reported using the economic resources measurement focus and the accrual basis of accounting.

(d) Use of Estimates

The preparation of the Schedule of Capital Assets in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and accumulated depreciation at the date of the schedule. Actual results could differ from those estimates.

(e) Valuation

Capital assets are reported at cost or estimated historical cost or, if donated, at their fair value at the time of acquisition. Historical costs include the amount paid for the asset and ancillary charges necessary to place the asset into its intended location and condition for use. Assets acquired in various amounts for a single purpose which may not individually meet the capitalization threshold are capitalized if the estimated total of the project exceeds the capitalization threshold.

For capital assets that are depreciated, expenditures that extend the useful lives of capital assets beyond their initial estimated useful lives (preservation costs) or improve their efficiency (improvements) or capacity (additions) are capitalized, whereas expenditures for repairs and maintenance are expensed.

Capital assets are depreciated using the straight-line method.

STATE OF ILLINOIS
DEPARTMENT OF NATURAL RESOURCES
NOTES TO SCHEDULE OF CAPITAL ASSETS – Continued

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

(f) Capitalization Policies

Capitalization thresholds and the estimated useful lives are as follows:

Capital Asset Category	Capitalization Threshold	Estimated Useful Life
Land	\$ 100,000	N/A
Infrastructure	250,000	30
Site Improvements	25,000	30
Buildings	100,000	30
Building Improvements	25,000	30
Equipment	5,000	7
Capital Leases - Equipment	5,000	7

(g) Infrastructure

The Department maintains infrastructure assets, including waterways, dams, tunnels, and drainage systems. The Department maintains certain infrastructure networks, composed of all assets that provide a particular type of service for the Department.

In the majority of cases, a legal title document was not created when these assets were constructed or placed into service. The Department capitalizes all infrastructure assets supported by purchasing documentation (e.g., contracts, requisitions, purchase orders, payment documents, etc.). In cases where infrastructure assets are jointly developed or constructed by the Department and neighboring states or local municipalities, the Department capitalizes only those assets which are maintained by the Department and legal title has not been established by another legal entity.

(h) Historical Treasures and Works of Art

The Department maintains extensive collections of historical treasures and works of art. Items meeting the following conditions are not capitalized: 1) held for public exhibition, education, or research in furtherance of public service, rather than financial gain; 2) protected, kept unencumbered, cared for, and preserved; and 3) subject to an organizational policy that requires the proceeds from sales of collection items to be used to acquire other items for collections. All Department historical treasures and works of art meet these conditions and are not capitalized in the Schedule of Capital Assets.

STATE OF ILLINOIS
DEPARTMENT OF NATURAL RESOURCES
NOTES TO SCHEDULE OF CAPITAL ASSETS – Continued

3. CAPITAL ASSET MANAGEMENT SYSTEM

The Department maintains a capital asset management system which includes for all capital assets the major asset category, description of asset, date of acquisition, method of acquisition, cost or other value, responsible organizational unit, location of asset, identification of applicable network or subsystem (for infrastructure assets), estimated life, estimated salvage value, annual and accumulated depreciation, and appropriation.

4. REPORTING REQUIREMENTS

The Department is required to complete and submit the *SAMS TO GAAP Reconciliation – Capital Assets* (SCO-537) and *Capital Asset Summary* (SCO-538) forms to the Illinois Office of the Comptroller as part of the year-end reporting process related to capital assets. Amounts reported on these forms have been reconciled to the Schedule of Capital Assets.

**STATE OF ILLINOIS
DEPARTMENT OF NATURAL RESOURCES**

Schedule of Changes in Capital Assets

**For the Year Ended June 30, 2007
(expressed in thousands)**

	<u>Balance At June 30, 2006</u>	<u>Additions</u>	<u>Deletions</u>	<u>Net Transfers</u>	<u>Balance At June 30, 2007</u>
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Site improvements	149,800	11,068	-	19,613	180,481
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Infrastructure	22,641	1,014	-	-	23,655
Equipment	58,637	4,079	725	(2,165)	59,826
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Total Capital Assets, net	<u>\$ 753,510</u>	<u>\$ 10,755</u>	<u>\$ 886</u>	<u>\$ 9,051</u>	<u>\$ 772,430</u>

See accompanying Independent Auditor's Report.



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

Honorable William G. Holland
Auditor General
State of Illinois

As Special Assistant Auditors for the Auditor General, we have audited the Schedule of Capital Assets of the State of Illinois, Department of Natural Resources, as of June 30, 2007, and have issued our report thereon dated January 8, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the State of Illinois, Department of Natural Resources' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the schedule and not for the purpose of expressing an opinion on the effectiveness of the State of Illinois, Department of Natural Resources' internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the State of Illinois, Department of Natural Resources' internal control over financial reporting.

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

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

financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described in the accompanying schedule of findings as finding 07-1 to be significant deficiencies in internal control over financial reporting.

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

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider item 07-1 to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State of Illinois, Department of Natural Resources Schedule of Capital Assets is free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement 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 State of Illinois, Department of Natural Resources' response to the finding identified in our audit is described in the accompanying schedule of findings. We did not audit the State of Illinois, Department of Natural Resources' response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Auditor General, the General Assembly, the Legislative Audit Commission, the Governor, and agency management, and is not intended to be and should not be used by anyone other than these specified parties.

Sehich LLP

Springfield, Illinois
January 8, 2008

SCHEDULE OF FINDINGS

07-1 FINDING: (Inadequate controls over the calculation and submission of capital asset information for GAAP reporting purposes)

The Department's primary capital asset and property control accounting system, the Common Inventory System (CIS) was not adequate for the proper calculation and submission of capital asset information for GAAP reporting purposes. As a result, the Department had to utilize numerous supplemental spreadsheets and schedules to calculate capital asset balances and related depreciation in accordance with Generally Accepted Accounting Principles (GAAP).

An important element of internal control is the accurate review, reconciliation and reporting of accounting data. In addition, the Statewide Accounting Management System (SAMS) (Procedure 27.20.38) requires a State agency to report capital assets and related accumulated depreciation.

We noted the following problems with CIS and the Department's fiscal year 2007 GAAP packages submission of the *SAMS to GAAP Reconciliation – Capital Assets* (SCO-537) and the *Capital Asset Summary* (SCO-538) forms, as well as the financial schedule – Schedule of Capital Assets:

- Previous audits noted numerous errors regarding the SCO-537 and 538 at June 30, 2002, 2003, 2004, 2005, and 2006 in order to meet reporting requirements under GASB 34. After a great deal of effort, ending balances at June 30, 2002 were recalculated based on 30 years of historical information obtained from the Department and the Capital Development Board (CDB). However, at that time, the ending balances did not reconcile to property listings on the Department's Common Inventory System (CIS). As of June 30, 2007, the Department still had not agreed the ending recalculations with CIS, including asset categorization and related accumulated depreciation amounts.

Within the CIS system, a significant number of capital assets contain erroneous information regarding category type due to the manner in which assets have been recorded. In addition, accumulated depreciation was incorrectly computed due to recording inaccurate dates in which the assets were placed into service. In order for the Department to utilize the property control system for capital asset reporting, each of the Department's property control items must be reconciled to information obtained from CDB and corrected within CIS. Because CIS has erroneous information and was not originally designed for reporting in accordance with GAAP, the Department must rely on extensive manual calculations performed by the Illinois Office of the Comptroller in order to calculate Capital Assets balances each year.

- Due to the incompleteness of CIS records, the Department could not obtain ending balances for each capitalization category from property control records without numerous supplemental spreadsheets.

- Since the Department was not relying on CIS for calculations, accumulated depreciation was required to be calculated manually.
- Due to the consolidation of tags and the manner in which the Department makes adjustments on the CIS system, the CIS system was unable to provide adequate documentation of actual additions, deletions, and transfers without numerous supplemental spreadsheets.
- The Department still has not included Office of Water Resources sites on CIS. These sites included dams, seawalls, levees, and other properties. The total amount related to these projects is approximately \$54 million. In addition, the Department still has not included Department of Transportation (IDOT) managed projects related to bikeways and roads on its property control records. The total amount related to these projects is approximately \$39 million. Each year the Department must make a manual adjustment to add these amounts to its Schedule of Capital Assets and its GAAP reporting forms submitted to the Illinois Office of the Comptroller.
- Due to the Department's process regarding the acquisition of land, the Department may have multiple items within the property control system that constitute one contiguous parcel of land. Due to the multiple items, the Department is unable to properly apply the categorization threshold to determine which parcels of land should be capitalized. Currently, the Department is reporting all parcels of land as Capital Assets.
- During our testing of additions, we noted 3 of 75 (4%) of invoices lacked a purchase requisition or other supporting documentation of approval and necessity for the purchase.
- During other testing, we noted 1 of 25 (4%) of items tested were classified improperly. During our expanded testing, we noted an additional seven items that were improperly categorized, totaling approximately \$2 million.

Based on the prior recommendation, the Department attempted to reconcile its CIS records to previously recomputed GAAP balances. However, the CIS system is outdated, making a reconciliation difficult and not cost beneficial. During the fiscal year, the Department obtained a new property control system, but due to timing of the conversion process, the system was not available for capital asset reporting as of June 30, 2007.

Additionally, the Department implemented procedures to report the Department's capital assets in an accurate and complete manner based on existing records. Specifically, the Office of the Comptroller assisted the Department with capital asset reporting, including the preparation and reconciliation of subsidiary supplemental spreadsheets and schedules.

Preparation of the Department's financial information related to capital assets as needed for GAAP reporting purposes utilizing a comprehensive accounting system is important due to the complexity of the Department capital assets and the impact possible adjustments have on the statewide financial statements. This is especially important as the Department has approximately \$1.137 billion of capital assets. The problems noted with the CIS system as well as other problems noted above weakens internal control over capital asset reporting and could result in erroneous financial reporting. (Finding Code No. 07-1, 06-1, 05-1, 04-3)

RECOMMENDATION:

We recommend the Department complete its conversion of its property control records to the new system, and implement procedures to ensure property control records contain accurate data, allowing for proper categorization, valuation, and application of thresholds.

DEPARTMENT RESPONSE:

We agree. The Department is working diligently to complete the conversion of our capital asset data for GAAP reporting purposes, as well as our property control data and procedures from the outdated CIS application to our new application. Our expectation is to have this conversion completed and certified by the Illinois Office of Internal Audit, who are currently conducting a review of the application, by this fiscal year. Accordingly, we are confident that our procedures, data and efficiency in GAAP reporting at June 30, 2008 will correct the deficiencies noted in this finding. Additionally, we sincerely appreciate the auditor's citing the positive efforts we had made toward correcting the deficiencies and the overall positive tone of the report and the support afforded by a reasonable and achievable recommendation.