

**STATE OF ILLINOIS
DEPARTMENT OF NATURAL RESOURCES**

FINANCIAL AUDIT OF CAPITAL ASSET ACCOUNT
June 30, 2005

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

Sikich LLP

CERTIFIED PUBLIC ACCOUNTANTS & ADVISORS

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

June 30, 2005

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**STATE OF ILLINOIS
DEPARTMENT OF NATURAL RESOURCES**

AGENCY OFFICIALS

Sam Flood	Director (Interim effective January 1, 2006)
Joel Brunsvold	Director (through December 31, 2005)
Leslie Sgro	Deputy Director
Vacant	Deputy Director
Ellen King-Pietrzak	Director of the Office of Fiscal Management (effective December 1, 2005)
Ann Sundeen	Director of the Office of Fiscal Management (through November 2005)
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
Jerry Jones	Director of Office of Mines and Minerals (through December 31, 2004)
Joe Angleton	Director of Office of Mines and Minerals (effective January 31, 2005)
Bob Roads	Director of Office of Capital Development (through October 15, 2004)
Randy Mitchell	Acting Director Office of Capital Development (through March 1, 2006)
John Evans	Director of Office of Capital Development (effective March 1, 2006)
Tony Mayville	Director of Office of Land Management and Education
Galen Westerfield	Director of Office of Law Enforcement
Kristin Dicenso	Director of Office of Public Services
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.



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, 2005. 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, 2005, 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, 2005 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 April 7, 2006 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.

Schick LLP

Springfield, Illinois
April 7, 2006

**STATE OF ILLINOIS
DEPARTMENT OF NATURAL RESOURCES**

Schedule of Capital Assets

**June 30, 2005
(expressed in thousands)**

Capital Assets not being depreciated:	
Land and land improvements	\$ 309,170
Total Capital Assets not being depreciated:	<u>309,170</u>
Capital Assets being depreciated:	
Site improvements	321,109
Building and building improvements	285,939
Infrastructure	39,591
Equipment	<u>71,697</u>
Total Capital Assets being depreciated:	<u>718,336</u>
Less Accumulated Depreciation for:	
Site improvements	139,180
Building and building improvements	102,952
Infrastructure	21,677
Equipment	<u>57,070</u>
Total Accumulated Depreciation	<u>320,879</u>
Total Capital Assets, being depreciated, net	<u>397,457</u>
Total Capital Assets, net	<u><u>\$ 706,627</u></u>

The accompanying Notes To Schedule of Capital Assets
are an integral part of this schedule.

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

June 30, 2005

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, 2005, and changes in its financial position, where applicable, 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 under 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, 2005.

(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

During fiscal year 2005, the Department revised estimated useful lives of capital asset categories. Any adjustment to capital assets and accumulated depreciation have been recognized on a prospective basis. The cumulative effect of this change in estimate reduced accumulated depreciation and current year depreciation expense by approximately \$3.4 million.

(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.

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

(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.

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 Ending June 30, 2005
(expressed in thousands)**

	<u>Balance At June 30, 2004</u>	<u>Additions</u>	<u>Deletions</u>	<u>Net Transfers</u>	<u>Balance At June 30, 2005</u>
Capital Assets not being depreciated:					
Land and land improvements	\$ 302,254	\$ 6,954	\$ 38	\$ -	\$ 309,170
Total Capital Assets not being depreciated:	<u>302,254</u>	<u>6,954</u>	<u>38</u>	<u>-</u>	<u>309,170</u>
Capital Assets being depreciated:					
Site improvements	315,156	3,318	1,690	4,325	321,109
Building and building improvements	280,252	932	125	4,880	285,939
Infrastructure	36,954	2,637	-	-	39,591
Equipment	70,499	4,004	1,128	(1,678)	71,697
Capital leases - equipment	145	-	145	-	-
Total Capital Assets being depreciated:	<u>703,006</u>	<u>10,891</u>	<u>3,088</u>	<u>7,527</u>	<u>718,336</u>
Less Accumulated Depreciation for:					
Site improvements	131,834	7,846	503	3	139,180
Building and building improvements	93,949	8,983	20	40	102,952
Infrastructure	20,876	801	-	-	21,677
Equipment	56,686	2,505	2,078	(43)	57,070
Capital leases - equipment	105	-	105	-	-
Total Accumulated Depreciation	<u>303,450</u>	<u>20,135</u>	<u>2,706</u>	<u>-</u>	<u>320,879</u>
Total Capital Assets, being depreciated, net	<u>399,556</u>	<u>(9,244)</u>	<u>382</u>	<u>7,527</u>	<u>397,457</u>
Total Capital Assets, net	<u>\$ 701,810</u>	<u>\$ (2,290)</u>	<u>\$ 420</u>	<u>\$ 7,527</u>	<u>\$ 706,627</u>

See accompanying Independent Auditor's Report.



**REPORT ON INTERNAL CONTROL OVER FINANCIAL
REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED
ON AN AUDIT 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, 2005, and have issued our report thereon dated April 7, 2006. 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 of the Schedule of Capital Assets in order to determine our auditing procedures for the purpose of expressing our opinion on the schedule and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the State of Illinois, Department of Natural Resources' ability to record, process, summarize, and report financial data consistent with the assertions of management in the Schedule of Capital Assets. Reportable conditions are described in the accompanying schedule of findings as item 05-1.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the Schedule of Capital Assets being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider item 05-1 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 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*.

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.

Schick LLP

Springfield, Illinois
April 7, 2006

FINDING (GOVERNMENT AUDITING STANDARDS)

05-1 FINDING: (Inadequate controls over the calculation and submission of capital asset information for GAAP reporting purposes)

The Department's preparation and submission of year end accounting reports (GAAP Package Forms) to the Office of the State Comptroller related to the capital asset account were not performed accurately, causing significant financial reporting delays. The inaccurate preparation of this submission negatively impacts the timely and accurate preparation of statewide financial statements prepared by the Office of the State Comptroller.

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 the Department's fiscal year 2005 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 and 2004 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, 2005, the Department still had not agreed the ending recalculations with CIS, including asset categorization and related accumulated depreciation amounts.
- Due to the incompleteness of CIS records, the Department could not obtain ending balances for each capitalization category from property control records. Without these amounts, we could not determine whether ending balances were reasonably stated. Extensive reconciliation and testing procedures were performed to verify ending balances.
- Since the Department was not relying on CIS for calculations, accumulated depreciation was being calculated manually. These amounts were calculated incorrectly and individual transaction amounts were not substantiated. Additional manual recalculations were required to properly calculate accumulated depreciation.

- Due to the consolidation of tags and the manner in which the Department makes adjustments on the CIS system, the Department was unable to provide adequate documentation of actual additions, deletions, and transfers. In addition, due to the consolidation process, several items changed category type from the previous fiscal year. No calculations were made related to these changes. In addition, the Department was unable to provide a complete listing of all consolidations and other adjustments.
- We noted inconsistencies in the manner in which historical treasures, works of art and other collections were recorded in the Department's records. While the Department maintains detailed records of its collections, in accordance with generally accepted governmental accounting standards, it is the Department's policy not to capitalize such collections. However, we observed that some collection items were capitalized in the Department's property records. In addition, the Department did not have adequate documentation regarding the amounts of historical treasures and works of art that are not capitalized. Adjustments were required to remove any amounts related to historical treasures and works of art from the capital asset account.
- The Department still has not included Department of Transportation (IDOT) managed projects related to bikeways on its property control records. The total amount related to these projects is approximately \$26,274,295, which was omitted from the Department's capital asset account. Adjustments were required to include amounts related to these site improvements within the capital asset account.
- The Department still has not included Office of Water Resources sites on property control records. These sites included dams, seawalls, levees, and other properties, and therefore these amounts were omitted from the capital asset account, and the Department failed to calculate fiscal year expenditures related to these projects. The total amount related to these projects is approximately \$39 million. Adjustments were required to include amounts related to infrastructure within the capital asset account.
- The Department was unable to properly calculate capital asset accounts payable. The Department materially overstated payables related to equipment and infrastructure, but failed to properly calculate any payables related to multi-year construction projects, resulting in significant audit adjustments.
- Due to the complexity of the above issues, revised amounts related to capital assets and accumulated depreciation were not available until April 6, 2006, more than seven months after the initial due date, and more than nine months after the end of the fiscal year.

The Department initially submitted GAAP reporting packages in August 2005 that did not contain accurate information. In order to correct these deficiencies, the Department contracted with a consulting firm to provide technical assistance in the preparation of these forms. Revised forms were submitted in November 2005. These submissions also did not contain accurate information and were unable to be reconciled to Department

records. The Department again attempted to correct these errors and omissions, submitting another submission in January 2006, but these amounts were also incorrect and did not agree to supporting documentation. Beginning in February 2006, the Office of the Comptroller began assisting the Department with this project. Final balances were provided by the Office of the Comptroller on April 7, 2006.

Based on the prior recommendation, the Department attempted to reconcile its CIS records to previously recomputed GAAP balances. However, the Department did not devote sufficient resources, including technical expertise, to facilitate these reconciliations.

Accurate preparation of the Department's financial information related to capital assets as needed for GAAP reporting purposes is important due to the complexity of the Department capital assets and the impact adjustments have on the statewide financial statements. This is especially important as the Department has approximately \$1.027 billion of capital assets. The failure to provide accurate information to the Office of the State Comptroller could result in errors and delays in the statewide financial statements. (Finding Code No. 05-1, 04-3)

RECOMMENDATION:

We recommend the Department implement procedures to ensure capital assets are reported in an accurate and complete manner. Also, the Department should reconcile the Common Inventory System to capital asset reporting amounts to ensure the property control system can be utilized for capital asset reporting. Further, the Department should review and revise, as necessary, its current system of gathering property control information to improve the accuracy of the Common Inventory System records and devote necessary personnel to these tasks.

DEPARTMENT RESPONSE:

We agree. The Department has already initiated corrective action as follows:

Early April, 2006: Advised Director and Executive Staff of condition and obtained their endorsement and support for necessary corrective action.

Mid April, 2006: Assembled and assigned tasks for asset confirmation deployment project. Began work on Human Resources Department to begin completion of the personnel authorization request for additional resource. Documentation of processes begun.

Late April: Completed field work of asset confirmation deployment project.

Early May: Initiated procurement of technical services and additional staff resources to supplement on board staff. Develop work procedures for standardized workpapers and reconciliation activity for FY05 adjusting journal entries and FY06 activity. Develop and document quality assurance review procedures.

Mid May: Compile (with coordination of Comptroller) detail of first nine months of activity for FY06 and reconcile to Comptroller's Data Warehouse. Refine and document methodology for estimating accounts payable for year end. Review and reconcile quarterly reports submitted to Comptroller (C-15s) to CIS and DataWarehouse.

May 31, 2006. Requesting return of Office of Auditor General's contract audit firm for interim testing procedures on FY2006 and FY2005 adjustments. Any adjustments to C-15s complete and submitted to Comptroller.