

DEPARTMENT OF NATURAL RESOURCES
STATE OF LOUISIANA



MANAGEMENT LETTER
ISSUED APRIL 10, 2013

**LOUISIANA LEGISLATIVE AUDITOR
1600 NORTH THIRD STREET
POST OFFICE BOX 94397
BATON ROUGE, LOUISIANA 70804-9397**

LEGISLATIVE AUDITOR
DARYL G. PURPERA, CPA, CFE

**FIRST ASSISTANT LEGISLATIVE AUDITOR
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THOMAS H. COLE, CPA

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LOUISIANA LEGISLATIVE AUDITOR
DARYL G. PURPERA, CPA, CFE

March 20, 2013

DEPARTMENT OF NATURAL RESOURCES
STATE OF LOUISIANA
Baton Rouge, Louisiana

As required by Louisiana Revised Statute 24:513 and as a part of our audit of the State of Louisiana's financial statements and the Single Audit for the State of Louisiana for the fiscal year ended June 30, 2012, we conducted certain procedures at the Department of Natural Resources (DNR) for the period from July 1, 2011, through June 30, 2012.

- Our auditors obtained and documented an understanding of the DNR operations and system of internal controls, including internal controls over major federal award programs administered by DNR, through inquiry, observation, and review of its policies and procedures documentation, including a review of the laws and regulations applicable to DNR.
- Our auditors performed analytical procedures consisting of a comparison of the most current and prior year financial activity using DNR's annual fiscal reports and/or system-generated reports and obtained explanations from DNR management of any significant variances.
- Our auditors reviewed the status of the findings identified in the prior year engagement. In our prior audit report on DNR, dated April 3, 2012, we reported findings relating to noncompliance with subrecipient monitoring requirements, noncompliance with allowable cost principles, inadequate controls over the compilation of the schedule of expenditures of federal awards, and inaccurate federal performance reports. The findings related to subrecipient monitoring, the compilation of the schedule of expenditures of federal awards, and inaccurate federal performance reports have been resolved by management. The finding relating to noncompliance with allowable cost principles has not been resolved and is addressed again in this letter.
- Our auditors considered internal control over financial reporting, examined evidence supporting DNR's state royalty revenues and receivables, and tested its compliance with laws and regulations that could have a direct and material effect on the State of Louisiana's financial statements, as part of our audit of the state's Comprehensive Annual Financial Report for the fiscal year ended June 30, 2012,

in accordance with *Government Auditing Standards*. Our auditors also scheduled royalty revenues by fiscal year for informational purposes.

- Our auditors performed internal control and compliance testing in accordance with *Government Auditing Standards* and Office of Management and Budget Circular A-133 on the State Energy Program (SEP, CFDA 81.041) for the fiscal year ended June 30, 2012, as part of the Single Audit for the State of Louisiana. Our auditors also scheduled the split of SEP expenditures by program for informational purposes.

The Annual Fiscal Reports of DNR were not audited or reviewed by us, and, accordingly, we do not express an opinion on those reports. DNR's accounts are an integral part of the State of Louisiana's financial statements, upon which the Louisiana Legislative Auditor expresses opinions.

Based on the application of the procedures referred to previously, we have included all significant findings that are required to be reported by *Government Auditing Standards*. The finding for noncompliance with allowable cost principles has been included in the State of Louisiana's Single Audit Report for the year ended June 30, 2012.

The following significant findings are included in this report for management's consideration:

Noncompliance with Allowable Cost Principles

DNR violated federal regulations by charging office rent directly to the State Energy Program while also including a portion of the office rent in the federal indirect cost pool. As a result, questioned costs totaling \$68,721 may need to be returned to the federal grantor. This is the second consecutive year for this finding.

Federal regulations state that a cost may not be allocated to a federal award as an indirect cost if any other cost incurred for the same purpose has been assigned to a federal award as a direct cost. DNR has not established controls to ensure that program costs included in the federal indirect cost pool are not also charged as direct costs to federal programs. Management should establish controls to ensure that future indirect program costs included in the federal indirect cost pool are not also charged directly to the federal award. Management concurred with the finding and recommendation and provided a corrective action plan (see Appendix A, page 1).

Inadequate Enforcement of Regulations

DNR, Office of Conservation, did not obtain survey plats for all oil and gas producing units as required by the Louisiana Administrative Code (LAC), which increases the risk that producing units will not be surveyed and landowners or interested parties' participation in those units will not be properly established for the accurate distribution of royalty payments. In addition, this prevents the Office of Conservation from ensuring that there is no overlap among units which could further contribute to the inaccurate distribution of royalty payments.

LAC 43:XIX.4103 requires the submission of survey plats to the Office of Conservation for approval before the plats are recorded in the respective parish clerk of court office. Each producing unit shall be surveyed and the survey plat shall be submitted for approval within 90 days after the issuance date of the unit order. If the unit is not producing minerals when the unit is created, the survey plat shall be submitted within 90 days after the date production commences.

Management has no effective process to identify and track survey plats that have or have not been received. Management should implement a process to identify and track all required survey plats and review these tracks timely to ensure that participation in the units has been properly established for the accurate distribution of royalty payments. Management concurred with the finding and recommendations and provided a corrective action plan (see Appendix A, page 2).

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

This letter is intended for the information and use of DNR and its management, others within the entity, and the Louisiana Legislature and is not intended to be, and should not be, used by anyone other than these specified parties. Under Louisiana Revised Statute 24:513, this letter is a public document, and it has been distributed to appropriate public officials.

Respectfully submitted,



Daryl G. Purpera, CPA, CFE
Legislative Auditor

MMG:ETM:BQD:THC:dl

APPENDIX A

Management's Corrective Action Plans and Responses to the Findings and Recommendations

BOBBY JINDAL
GOVERNOR



STEPHEN CHUSTZ
INTERIM SECRETARY

State of Louisiana
DEPARTMENT OF NATURAL RESOURCES
OFFICE OF MANAGEMENT AND FINANCE
ROBERT D. HARPER, UNDERSECRETARY

February 26, 2013

Mr. Daryl G. Purpera, CPA, CFE
Louisiana Legislative Auditor
Post Office Box 94397
Baton Rouge, Louisiana 70804-9397

RE: Noncompliance with Allowable Cost Principles

Dear Mr. Purpera:

The Department of Natural Resources concurs with the above reference finding. Ms. Gwen Thomas, Department Fiscal Officer, is responsible for implementing internal controls to ensure this does not happen again. As of the date of this letter, these controls have been implemented. Indirect cost procedures have been modified to exclude rent calculations when rent is charged to a grant as a direct cost of the grant.

Your assistance in this matter is appreciated.

Sincerely,

A handwritten signature in black ink that reads "Robert D. Harper".

Robert D. Harper
Undersecretary

RDH/mh

BOBBY JINDAL
GOVERNOR



STEPHEN CHUSTZ
INTERIM SECRETARY

State of Louisiana
DEPARTMENT OF NATURAL RESOURCES
OFFICE OF MANAGEMENT AND FINANCE
ROBERT D. HARPER, UNDERSECRETARY

February 27, 2013

Mr. Daryl G. Purpera, CPA, CFE
Louisiana Legislative Auditor
Post Office Box 94397
Baton Rouge, Louisiana 70804-9397

RE: Inadequate Enforcement of Regulations

Dear Mr. Purpera:

The Department of Natural Resources, Office of Conservation ("Conservation") remains committed to ensuring through implementation of its legal authority that all mineral owners in the State receive their just and equitable share from unit oil or gas production. Conservation concurs with the finding that the current process to identify and timely obtain survey plats for all oil and gas producing units as required by LAC 43:XIX.4103 is inadequate. Mr. Gary Ross, Deputy Assistant Secretary for the Office of Conservation, has initiated efforts to coordinate the resources of the agency's Geological and Engineering Divisions, and DNR's Information Technology section to establish and implement an automated control process through DNR's SONRIS system to identify and track required survey plats for unit production commencing after January 1, 2013. The mechanism for monitoring will involve tracking initiation of unit production, coupled with the issuance of a compliance order to the operator if the required plat is not timely received. It is anticipated that this process will be functional by June 30, 2013.

Your assistance in this matter is appreciated.

Sincerely,

A handwritten signature in black ink that reads "Robert D. Harper".

Robert D. Harper
Undersecretary

RDH/mh