

# Secretary of State Audit Report

Jeanne P. Atkins, Secretary of State

Mary Wenger, Interim Director, Audits Division



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## Department of Geology and Mineral Industries: Actions Taken to Better Manage Federal Funds, but Further Improvements Needed

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### Executive Summary

The Department of Geology and Mineral Industries encountered challenges that contributed to serious financial reporting and cash flow issues. In 2016, new department management started to make improvements and has implemented some financial controls, but further improvement is needed.

### Department is addressing lack of controls over federal grant processing

The majority of the department's revenue is derived from Other Funds and Federal Funds, which are received through cooperative agreements and fee-for-services projects. In fiscal year 2015, the department recorded \$4.7 million of federal revenues and expected about the same for fiscal year 2016.

From fiscal year 2014 through fiscal year 2015, the department experienced significant turnover in leadership and fiscal staff positions, resulting in a loss of institutional knowledge and experience and contributing to serious financial reporting and cash flow issues at the department.

Further, a lack of adequate controls contributed to the department using inappropriate grant management practices including 1) drawing down federal monies prior to incurring expenditures; 2) inaccurately reporting federal expenditures in the Schedule of Expenditures of Federal Awards; 3) untimely reporting indirect costs; and 4) inadequate supporting documentation.

In collaboration with a review team from the Department of Administrative Services, in 2016 new management began implementing a number of changes to strengthen controls over financial processes.

Management is also in the process of developing policies and procedures over financial processes. At the time of our audit, however, formal policies and procedures had not yet been adopted.

## **Recommendations**

We recommend the Department of Geology and Mineral Industries continue to improve internal controls over financial processes, including the proper recording and reporting of federal program monies. Our specific recommendations can be found on Page 10 of this report.

## **Agency Response**

The Department of Geology and Mineral Industries (department) concurs with the findings and recommendations of the audit report. The department will implement all recommendations as part of its ongoing efforts to improve financial and business practices. The department's full response, including the implementation status of each recommendation, can be found at the end of this report.

## Background

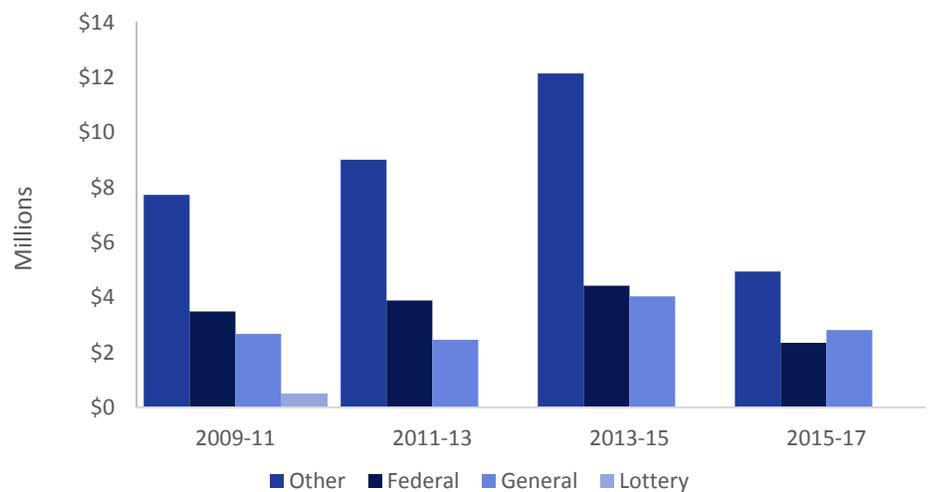
The Department of Geology and Mineral Industries (department) was created in 1937 and is Oregon's source of geologic information. The department's early emphasis on mining has expanded over the years to include helping Oregonians understand and prepare for natural hazards that accompany the state's geology. Mapping the state's varied geology and natural hazards, such as earthquakes, tsunamis, landslides, and coastal erosion, is a primary function of the department.

The department regulates surface mining, oil, gas, and geothermal resource exploration. Its most widely recognized product is the creation of geologic maps. These maps are valuable tools for a variety of uses, including describing the general geology and geologic history of an area, locating potential mineral resources, identifying geologic hazards, and providing essential information for groundwater studies.

### ***Program operations are primarily funded through cooperative agreements and fee-for-services activities***

Figure 1 shows the majority of the department's revenue over the prior three biennia was derived from Other Funds and Federal Funds. These funds are primarily received through cooperative agreements and fee-for-services on reimbursable projects.

**Figure 1: Revenue Trend by Funding Source**



Note: Data shown for the 2009-11 and 2011-13 biennia reflect actual revenue. The data shown for the 2013-15 and 2015-17 biennia reflects the legislatively approved or adopted budget amounts as the actual revenue data was not available.

### ***Department encountered challenges and underwent financial review***

In early 2015, the department's new management found themselves in need of a business process review and contacted the Department of Administrative Services (DAS) for assistance. A team was in place for several weeks in 2015 and observed a number of conditions that needed attention with regard to business and financial processes.

From 2014 to 2015, the department had significant turnover in leadership and fiscal staff positions. The loss of financial management support left the department with serious financial reporting and cash flow issues. As a result of these cash flow issues, a number of management and key staff positions were left vacant as a cost-savings measure. The DAS review team found these conditions were exacerbated by an archaic accounting structure that made it difficult for the new chief financial officer and new management to gain an understanding on the financial condition of the agency.

The review team put management in touch with several DAS financial work areas to begin improving business processes. The department implemented a number of changes, including contracting with DAS Shared Client Services and DAS Payroll to provide fiscal, accounting and payroll services. The department also worked with DAS to create a new budget and accounting structure.

A department director was appointed in December 2015, and in February 2016 the new director requested an audit to address "gaps in the department's financial information and a general lack of clarity about previous processes." The request was further narrowed to an audit of the department's key financial controls with a focus on fiscal year 2015 federal programs and an abbreviated review of fiscal year 2016 federal programs.

Concurrently, the U.S. Department of Homeland Security's Federal Emergency Management Agency (FEMA) conducted a site visit review of the department. The purpose of the review was to provide guidance and recommendations to enhance the department's efforts in managing federal funds. The review encompassed eight FEMA grants managed by the department. No findings were reported by FEMA.

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## Audit Results

### **New management is beginning to correct the lack of controls in federal grant management practices**

The department's past significant turnover in leadership and financial support personnel led to a loss of institutional knowledge and experience. As a result, new management is not aware of any financial controls related to federal revenues and expenditures that were in place prior to fiscal year 2016. Current management explained that there did not appear to be any formal, written policies and procedures or desk procedures related to financial processes.

Department management is responsible for establishing and maintaining internal controls that provide reasonable assurance that operations run effectively and efficiently, financial reporting is reliable, and applicable laws and regulations are complied with. Based on our audit, a lack of internal controls contributed to inappropriate federal grant management practices, which included 1) drawing down federal monies prior to incurring expenditures; 2) inaccurately reporting federal expenditures in the Schedule of Expenditures of Federal Awards; 3) untimely reporting indirect costs; and 4) inadequate supporting documentation.

If the department does not have effective financial controls, it could jeopardize future federal funding. This, in turn, could affect the progress of its federally funded projects.

Management is beginning to correct many of the former practices we saw evident in the fiscal year 2015 federal project files. Management also implemented some controls in fiscal year 2016 and is developing policies and procedures for its financial processes. At the time of our audit, however, formal, written policies had not yet been adopted.

#### ***Formerly, the department routinely drew federal monies prior to incurring program expenditures***

The department reported approximately \$4.7 million in federal revenues during fiscal year 2015 and expected about the same amount in fiscal year 2016. Federal grants are awarded to the department primarily from the Federal Emergency Management Agency, the Bureau of Land Management (BLM), the United States Geological Survey agency, and the National Oceanic and Atmospheric Administration. Additional federal awards are provided by the U.S. Army Corps of Engineers, and the U.S. Department of Agriculture's Natural Resource Conservation Service. Many of the department's federal awards are for mapping the state's geology and natural hazards.

The department's federal grants generally operated on a reimbursement basis, which means expenditures must be incurred prior to requesting

federal reimbursement. Advance payments did not appear to be expressly permitted in the grant agreements between the department and its federal partners.

The department usually submits a *Scope of Work* with its federal grant proposals, outlining a plan for work to be accomplished. For the federal awards we reviewed, the following payment terms were generally included in the *Scope of Work* document:

- 40% initial payment upon collection of data
- 30% payment upon first data delivery for Quality Control pass/fail exam by the department
- 30% payment upon final acceptance

The department's practice had been to draw down 40% of the total grant award as soon as a purchase order was approved for contracted work. Staff explained the initial draw was viewed as a way to help alleviate the department's cash flow issues. Staff stated they were unaware that federal monies should not be advanced in this manner.

Our testing of fiscal year 2015 federal draws confirmed the department was routinely drawing funds prior to incurring federal program expenditures, but not always adhering to this 40%-30%-30% schedule. In one instance, in January 2015 the department drew \$374,360 for one BLM grant for which no expenditures had been incurred. The draw represented about 70% of the total grant award of \$534,800. Based on supporting documentation, the department did not incur expenditures for the majority of the advanced funds until a year later.

Our review of fiscal year 2015 federal draws identified other advances that, at the time of our audit, did not appear to be supported by underlying expenditures. At fiscal year-end 2015, for the federal draws we reviewed, approximately \$295,762 appeared to have exceeded recorded expenditures.

During fiscal year 2016, management made efforts to eliminate the practice of advancing funds. Our testing showed the department still drew some federal funds in advance early in the fiscal year, but the frequency had significantly declined by February 2016.

***Fiscal year 2015 federal expenditures were not accurately recorded and reported***

DAS policy requires agencies receiving federal monies to use specific coding in the state's accounting system to record federal grant expenditures and revenues. Without correct codes, federal grants may not be accurately recorded and reported.

As a recipient of federal monies, the department is required to accurately report program expenditures on the state's Schedule of Expenditures of Federal Awards (SEFA).

In gaining our understanding of the department’s federal revenue account, we compared fiscal year 2015 federal revenue recorded in the state’s financial accounting system to federal expenditures reported by the department on the SEFA. As shown in Figure 2, federal revenues and expenditures were \$4.7 million and \$6.9 million, respectively. The federal expenditures reported by the department on its fiscal year 2015 SEFA was \$1.2 million or about \$3.5 million less than the recorded federal revenues.

**Figure 2: Federal Revenues and Related Expenditures (Fiscal Year 2015) per the Accounting System**

	Revenues	Expenditures
Attributed to Specific Federal Grants	\$ 1,191,615.52	\$ 1,191,615.52
Not Attributed to Specific Federal Grants	3,516,288.31	5,748,152.92
Total	\$ 4,707,903.83	\$ 6,940,468.44

Management explained its understanding that, formerly, payment of expenditures to third party contractors were treated as pass-through dollars and not associated with the respective federal grant awards and, thus, were not reported on the SEFA.

Furthermore, the department’s accounting records showed federal expenditures exceeded federal revenues by approximately \$2.2 million when these amounts should generally be about the same. These transactions also were not properly coded in the state’s accounting system with specific federal award or project information, making it difficult to determine which transactions related to which projects and awards.

During fiscal year 2016, new management implemented changes to the department’s accounting structure and processes. The department is now in compliance with DAS policy and records each federal expenditure by grant and project number. Tracking expenditures in this manner should enable the department to more accurately track and report federal expenditures.

***Indirect costs charged to federal grants were not always reported timely***

The federal government allows recipients of federal grant awards to charge an indirect cost rate to federal programs to facilitate the allocation and billing of indirect costs. The indirect rate is negotiated annually between the department and the U.S. Department of Interior and other federal agencies and is applied to grants, contracts, and other agreements with the federal government, as applicable.

Typically, recipients of federal funds claim indirect costs when they draw down federal cash. We found the department did not always record indirect costs timely in the state’s accounting system. In many cases indirect costs were recorded in a lump sum after several draws had already been made. This practice made it difficult to link the indirect costs with related expenditures and cash draws. At the time of our audit, some

indirect costs had not yet been recorded, as the department was still implementing a new process for recording indirect costs.

***Supporting documentation was not always retained or readily accessible***

Department management is responsible for maintaining a system of internal controls that includes retaining supporting documentation for federal financial transactions and having the documentation readily available for examination.

As previously noted, department management is unaware of any financial controls related to federal revenues that were in place prior to fiscal year 2016. The department has implemented some controls in fiscal year 2016 and is developing policies and procedures.

The department's records for fiscal year 2015 were not organized in an orderly manner that allowed for easy retrieval. For example, records were not in date or document number order.

Department personnel could not locate several fiscal year 2015 revenue and related expenditure documents for cash draws selected for testing. These missing documents represented \$84,150 in expenditures and related to five of the 28 cash draws we reviewed. We noted improvements in the department's document management for fiscal year 2016.

We also noted a number of documentation issues related to payroll costs charged to federal grants.

- Not all timesheets requested were located.
- Not all timesheets reviewed displayed a supervisor's approval.
- Not all timesheets reviewed supported the payroll costs charged to federal grants.

Department management explained the payroll expenditures were reviewed monthly with program managers to ensure costs were reasonable and appropriate. This review was not formally documented, however, and could not be tested to determine if it was a consistent control.

The department is implementing a process whereby employees can charge time to their assigned projects on a continuous basis. This will eliminate the need for financial staff to review timesheets with managers to determine what projects should be attributed to federal awards.

## Other Matters

### ***Some minor expenditures charged to federal programs may not be allowable***

The U.S. Office of Management and Budget provides basic criteria to determine whether an expenditure is an allowable program cost. Specifically, the expenditure must be necessary and reasonable for the performance and administration of the federal award.

The majority of the department's federal expenditures appeared to be associated with the collection of Light Detection and Ranging (LIDAR) data. Based on our review of the department's federal grant awards, we concluded the costs associated with the collection of LIDAR data were allowable. However, during the audit we noted other expenditures charged to federal programs that may not be allowable.

Management had previously identified a number of these expenditures, including bottled water totaling \$1,033 and \$318 for gifts for the prior Director's retirement. Management reported it had taken measures to address these items within the department.

In addition to the expenditures identified by management, our review of fiscal year 2015 federal expenditures found one \$425 transaction for towing charges billed to a federal program. The charge did not appear to provide a direct benefit to the program, and, therefore, may not be allowable.

Beginning with fiscal year 2016, the new Uniform Guidance (200.302(b)(7)) requires recipients of federal awards to establish written procedures for determining whether federal program costs are allowable. At the time of our audit, the department had not yet developed a policy or procedures for allowability.

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## Recommendations

To help department management strengthen existing controls, we recommend management:

- continue to formalize policies and procedures for recording and reporting federal revenues and expenditures, which should include written procedures for determining whether federal program costs are allowable;
- continue efforts to eliminate the practice of advancing federal monies prior to incurring expenditures for reimbursable grants;
- continue to track federal expenditures by grant and project numbers in accordance with state policy to improve the accuracy of information reported on the department's SEFA;
- implement controls to ensure indirect costs are recorded accurately and timely in the state's accounting system;
- develop and implement formal controls over payroll expenditures (review of payroll reports, etc.); and
- continue to develop a filing system that will facilitate record retention and retrieval.

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## Objectives, Scope and Methodology

The objectives of our audit were to review the department's financial controls related to federal revenues and to determine whether federal revenues were accounted for properly.

To meet our objectives, we interviewed department management and staff, and reviewed relevant department records. We reviewed the department's fiscal year 2015 Schedule of Expenditures of Federal Awards and compared federal revenues to expenditures for that time period. We also reviewed available grant award documentation.

We analyzed fiscal year 2015 and 2016 data from the department's accounting system. We conducted data reliability tests and concluded that the data was reliable for our audit purposes. Additional historical data was obtained from the department's legislatively adopted budget analyses prepared by the State of Oregon's Legislative Fiscal Office.

We selected separate samples of federal draws for fiscal years 2015 and 2016. For fiscal year 2015, we reviewed all federal draws exceeding \$218,000 and reviewed a sample of 25 from the remaining 51 draws.

For fiscal year 2016, we reviewed all federal draws exceeding \$160,000 and reviewed 12 of the remaining 29 draws. At the time of the audit, fiscal year 2016 had not yet closed so we selected our sample from transactions entered into the state's accounting system from July 1, 2015 through February 29, 2016.

After identifying and selecting our samples, we requested documentation supporting each cash draw. We verified that the revenue recorded in the accounting system was actually received by tracing the draw amount to the department's bank statements. If documentation was available, we agreed the recorded revenue to supporting invoices to determine whether the revenue was supported by underlying expenditures, and whether the expenditure was allowable for purposes of the related federal program. We reviewed revenue accrual transactions input at the end of fiscal year 2015 to verify they were supported.

The samples we selected were not intended to identify all weaknesses in the department's internal controls. Nor were the samples designed to be statistically representative of the populations from which they were drawn. As such, we did not project our results based on the sample to the respective populations.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained and reported provides a reasonable basis to achieve our audit objective.

Auditors from our office, who were not involved with the audit, reviewed our report for accuracy, checking facts and conclusions against our supporting evidence.



# Oregon

Kate Brown, Governor

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October 28, 2016

Mary Wenger, Interim Director  
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RE: Department of Geology and Mineral Industries Response to Secretary of State Audit Report on  
Managing Federal Funds

Dear Ms. Wenger:

Thank you for the opportunity to respond to the Secretary of State Audit Report on Managing Federal Funds. The Department of Geology and Mineral Industries (DOGAMI) sincerely appreciates the work of the Audit Team in conducting this review and developing recommendations for further improvements to our financial processes. DOGAMI concurs with the findings of the report and agrees with all recommendations.

Implementation of the recommendations is in progress and actions taken to date are detailed in the attached response to recommendations. Please let me know if you have any questions regarding our response.

Sincerely,

Brad J. Avy  
Director

cc: Kimberly D. Riddell, Chief Financial Officer

## DOGAMI Response to Secretary of State Audit Report Recommendations

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**Recommendation** – *Continue to formalize policies and procedures for recording and reporting federal revenues and expenditures, which should include written procedures for determining whether federal program costs are allowable.*

**Status:** In Progress. Anticipated approval date of November 10, 2016 for federal and non-federal financial policies and procedures written to-date include:

- Releasing Reclamation Security – Cash Security (FIN 2016-01)
- Releasing Reclamation Security – Non-Cash Closure and Transfer (FIN 2016-02)
- Deposits – Mineral Land Regulation and Reclamation (FIN 2016-03)
- Deposits – Geologic Survey and Services (FIN 2016-04)
- Accounts Payable (FIN 2016-05)
- Federal Draw – ASAP.gov (FIN 2016-06)
- Federal Draw – FEMA PARS (FIN 2016-07)
- Legislature Approval for Federal Grant Application (FIN 2016-08)

DOGAMI-specific processes that align with DAS policies and procedures have been adopted for Travel, SPOTS, and Accounts Receivable.

**Ongoing Action:** Written policy and procedures are in progress for indirect allocations, complaint procedures, conflict of interest, e-payroll review and approval, and allowable costs.

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**Recommendation** – *Continue efforts to eliminate the practice of advancing federal monies prior to incurring expenditures for reimbursable grants.*

**Status:** Complete. This practice has been eliminated. Federal monies are currently being drawn according to actual costs within the grant at the time of draw and according to backup documentation. No ‘pending’ costs are drawn until actual charge is recorded in the statewide accounting system.

**Ongoing Action:** DOGAMI will continue to draw funds for actual costs as recommended.

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**Recommendation** – *Continue to track federal expenditures by grant and project numbers in accordance with state policy to improve the accuracy of information reported on the department’s SEFA.*

**Status:** Complete. All revenue and expenditure contracts are currently assigned a unique identifier for accurate tracking. Revenue contracts are also assigned a unique grant and project number including phase numbers appropriately and according to any amendments or modifications of the contract. All grants are established in the statewide accounting system with the Catalogue of Federal Domestic Award (CFDA) number if federal or federal as other funds, and non-federal grants are established with the default 99.999 CFDA number for distinction and accurate SEFA reporting.

**Ongoing Action:** DOGAMI will continue to track expenditures as recommended.

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## DOGAMI Response to Secretary of State Audit Report Recommendations

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**Recommendation** – *Implement controls to ensure indirect costs are recorded accurately and timely in the state’s accounting system.*

**Status:** Complete. The system for indirect costs being recorded into the state accounting system accurately has been established. Indirects are up to date and recorded into the state accounting system monthly.

**Ongoing Action:** DOGAMI will continue to implement controls as recommended and write a policy and procedure for indirect costs by December 31, 2016.

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**Recommendation** – *Develop and implement formal controls over payroll expenditures (review of payroll reports, etc.).*

**Status:** In Progress. The agency transitioned from paper timesheets to the Department of Administrative Services “e-payroll” system in early 2016. With this electronic system, employees enter their time using unique project-assigned coding and the supervising manager reviews and “locks” the timesheet electronically. The agency’s new organizational structure, effective January 1, 2017, will provide additional oversight and review of project work codes.

**Ongoing Action:** Training on payroll review, and policies and process will be developed by December 31, 2016 and maintained on an ongoing basis.

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**Recommendation** – *Continue to develop a filing system that will facilitate record retention and retrieval.*

**Status:** Complete. A contract filing system has been developed and captured as a written process to ensure consistency. The system includes designation of contracts as federal or non-federal for quick differentiation and internal organization of contracts with standard sections of:

- Contract/Agreement
- Invoices/Draws
- Reports
- Sub or partner agreements
- Correspondence

**Ongoing Action:** DOGAMI will continue to follow the filing system that has been developed.

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## About the Secretary of State Audits Division

The Oregon Constitution provides that the Secretary of State shall be, by virtue of her office, Auditor of Public Accounts. The Audits Division exists to carry out this duty. The division reports to the elected Secretary of State and is independent of other agencies within the Executive, Legislative, and Judicial branches of Oregon government. The division is authorized to audit all state officers, agencies, boards, and commissions and oversees audits and financial reporting for local governments.

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### Audit Team

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V. Dale Bond, CPA, CISA, CFE, Audit Manager

Alan Bell, MBA, CFE, Principal Auditor

Katie Hull, Staff Auditor

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This report, a public record, is intended to promote the best possible management of public resources. Copies may be obtained from:

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The courtesies and cooperation extended by officials and employees of the Department of Geology and Mineral Industries during the course of this audit were commendable and sincerely appreciated.