Secretary of State Audit Report

Kate Brown, Secretary of State

Gary Blackmer, Director, Audits Division

Department of Energy: Strengthen Procedures and Documentation

Summary

The Oregon Department of Energy (Department) works to ensure that Oregon's energy resources minimize harm to the environment while reliably meeting the state's energy needs. To achieve this mission, the Department formulates energy policies, advances the development of renewable energy resources, and evaluates proposed siting of energy facilities for safety and environmental impact. The Department also oversees the cleanup and safe transport of radioactive waste and develops and implements emergency plans in the event of an accident involving radioactive materials.

The Department has experienced a substantial expansion and changes in management in a short time period. For the 2009-11 biennium, the Department's budget increased by $70 million or 37% over the previous budget. Most of the increase resulted from federal American Recovery and Reinvestment Act funds, directed towards energy efficiency improvements and support for renewable energy projects. In addition, in May 2009, Governor Kulongoski appointed a new Interim Director and key members of the management team were replaced. Subsequently, in May 2010, the Governor appointed an Acting Director.

The Department of Administrative Services directed an initial review of some Department functions and issued a report in December 2009. In February 2010, Department management asked the Secretary of State to evaluate the Department's business processes in three areas: contracting and procurement, accounts payable and receivable, and information security.

Our audit identified several areas where the Department could improve including contractor selection, sponsorship decision-making, energy supplier assessment data monitoring, accounts receivable collection, and electronic information security.

The Department's contractor selection processes could be improved to better ensure impartiality and better document that contractors were selected properly. This is of particular concern

when the Department awards contracts to former employees. We found that some contract deliverables lacked specificity, selection decisions needed better documentation, and newer contracts lacked provisions for the recently adopted False Claims Act.

Similarly, decisions to sponsor energy-related conferences and organizations were lacking in documentation. The Department spent $157,500 from fiscal year 2008 through fiscal year 2010 to sponsor 63 efforts, but we found no evaluations of benefits relative to costs, or procedures for determining which efforts to sponsor.

With a few exceptions, we found the Department provided adequate oversight of small purchases, travel, and payroll. In our sample of 40 credit card purchases, all the expenditures were appropriately supported and approved. We noted a 22% reduction in Department travel expenses over the past two fiscal years. We also tested 20 travel claims totaling approximately $9,350 and generally found proper documentation and support.

In addition, we tested 112 payroll transactions and concluded they were appropriate. However, we found the Department paid two Director salaries for a one-year period. The former Director, when moved to a non-director position in another agency, remained an employee of the Department for one year in the same position classification and at the same salary at the direction of Governor Kulongoski. Additionally, the Department reimbursed the payroll expenditures for the Interim Director during this time period.

A portion of the Department's revenues come from assessments of energy suppliers. However, the gross revenues the suppliers reported to the Department were not required to be independently verified. To ensure the reported amounts are reasonable, the Department should consider requiring a verified source for the revenues.

The Department could better collect revenue that it is due. We found that 73 percent of $228,000 in receivables was delinquent. The Department should turn over delinquent accounts to the Department of Revenue for collection as provided in state law, and send more timely and progressively stronger letters for delinquent accounts.

As a result of our review, the Department reduced employee access to Department buildings during non-business hours to improve its information security. The Department also needs to improve planning for business continuity in the event of a security incident or disaster.

We recommend that the Department bolster its contracting procedures, develop procedures for awarding sponsorships, require verification of energy supplier gross revenues used for assessments, improve receivable collections, and update and expand its plans for information security to address business continuity and incident response.

During our audit we identified a contracting issue that was subsequently referred to the Department of Justice. The Department of Justice then launched an investigation and asked that we refrain from issuing our report. Consequently, the issuance of our audit report was delayed.

Agency Response

The agency response is attached at the end of the report.

Background

The mission of the Oregon Department of Energy (Department) is to ensure Oregon has an adequate supply of reliable and affordable energy and is safe from nuclear contamination. The Department helps Oregonians save energy, develops clean energy resources, promotes renewable energy, and cleans up nuclear waste.

The Department staffs two statutory boards:

- The Energy Facility Siting Council, a seven-member citizen board appointed by the Governor that decides whether large energy facilities may be built in Oregon; regulates the construction, operation, and decommissioning of energy facilities; and oversees the disposal of low-level radioactive wastes, and

- The Hanford Cleanup Board, a 20-member board that addresses issues at the nuclear site with a focus on protecting the Columbia River and ensuring safe transport for shipments of radioactive waste.

The Department offers tax credits, loans and grants to individuals and other entities to encourage investments in conservation, efficiency, and renewable energy resources. Tax credits include the Residential Energy Tax Credit (RETC) and the Business Energy Tax Credit (BETC). Oregon homeowners and renters can receive a RETC for improving the energy efficiency of their homes by purchasing energy efficient products or technologies. These products and technologies include energy efficient appliances, heating and air conditioning systems, and solar technologies. Oregon businesses can receive a BETC for energy conservation projects, recycling, renewable energy resources and using less-polluting transportation fuels.

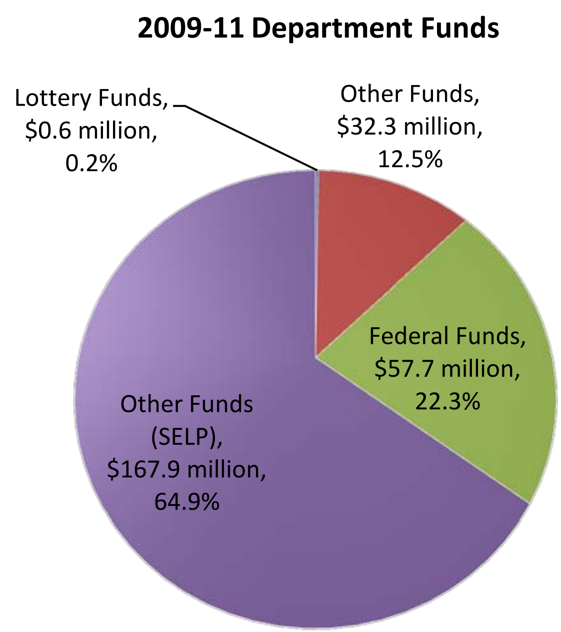
For the current biennium, as shown in Figure 1, the Department's budget increased to approximately $260 million, about $70 million or 37% more than the 2007-09 budget. Most of this increase, about $52 million, is federal funding from the American Recovery and Reinvestment Act (ARRA). The Department has directed these funds to energy efficiency and renewable energy programs in state, tribal and local governments. Most of the ARRA projects needed quick approval since the funds had to be committed by September 30, 2010. The Department added new employees and redirected existing staff responsibilities towards this endeavor.

FIGURE 1

Legislative Budget Overview			
	2005-2007 Actual	2007-2009 Legislatively Approved	2009-2011 Legislatively Adopted
General Fund	$ 0	$ 3,100,000	$ 0
Lottery Funds	0	0	590,347
Other Funds	16,989,048	22,095,949	32,298,391
Federal Funds	3,781,133	5,622,500	57,739,196
Other Funds (NL)	82,101,876	158,006,507	167,916,815
Total Funds	$102,872,057	$188,824,956	$258,544,749
FTE	87	91	113
From Legislative Fiscal Office Analysis of 2009-11 Legislatively Adopted Budget			

As shown in figure 2, of the approximately $260 million of expected funds for the 2009-11 biennium, the largest amount is about $168 million from the Department's Small-Scale Energy Loan Program (SELP), which includes general obligation bond sales, loan repayments, and interest income. Other sources of expected funds for the biennium, in addition to ARRA funds, include lottery funds and other funds such as energy supplier assessments, settlement funds, application fees for the Business Energy Tax Credit, and energy siting fees.

FIGURE 2



In May of 2009, leadership at the Department changed. Governor Kulongoski appointed an Interim Director, and key members of the management team were also replaced. These changes, along with the additional ARRA funding, resulted in substantial expansion and reorganization at the Department in a short period of time. Subsequently, in May 2010, the Governor appointed an Acting Director.

Shortly after the new and interim managers were in place in 2009, the Department of Administrative Services directed a review, at Department management's request, of certain key central services functions and issued a report in December 2009. In February 2010, Department management asked the Secretary of State to further evaluate the Department's business processes in three areas: contracting and procurement, accounts payable and receivable, and information security. As part of this work, we evaluated the Department's safeguards to ensure applicable laws and rules were followed and Department assets were adequately protected.

Audit Results

Our audit found the Department needed to improve its policies and procedures, contracting process, sponsorship evaluations, monitoring of energy suppliers' reported revenues, collection of delinquent accounts, and security of electronic information. We also noted that the former Director, although moved to a non-director position in another agency, remained an employee of the Department for one year in the same position classification and at the same salary.

Contractor Selection and Other Procedures Need Strengthening

Oregon law states that a sound and responsive public contracting system should provide for impartial and open competition. We reviewed 21 Department contracts that were in active status at some point during the period July 2008 to March 2010. The not-to-exceed amounts for these contracts totaled about $3.4 million and payments totaled about $1.6 million. The Department generally included all required contract elements in Requests for Proposals and final contracts, and the contracts were properly approved. However, the Department's contractor selection processes could be improved to better ensure impartiality and better document that contractors were properly selected. For example, Department employees who evaluate contractor proposals are required to disclose actual conflicts of interest that would result in a financial benefit to themselves or their relatives. However, they are not required to disclose any professional or personal relationships they have with proposers that might also compromise their independence. This is of particular concern since the Department has awarded contracts to former employees and to businesses that employed former employees. Documented disclosure and evaluation of all potential independence issues would help ensure an impartial and competitive process.

As noted below, we found several other areas where the Department did not follow proper contracting rules or best practices:

- Evaluation criteria for scoring contractors' cost proposals were not always well-defined and could be improved to help the Department select the best overall proposal.

- Original evaluation scores were changed without consistent, adequate documentation to justify the changes.

- Contract deliverables were not always clearly defined. For example, a contract for weatherization inspections required the contractor "to document inspections and report results" to the Department, but did not define the results to be reported. Additionally, the contractor was not required to submit inspection reports, which were one basis for contractor payments, to the Department.

- Disclosure and approval of subcontractor rate changes were not consistently required by the Department. Consequently, the Department could not be sure rates were reasonable for the services received. Since contractors often include a 10 percent service charge for "direct expenses," which include subcontractors' charges, increases in these charges would increase overall contract costs.

- Language in newer contracts did not cover Oregon's newly implemented False Claims Act. This act makes it unlawful to obtain a benefit from the state by making a request or claim that contains untrue information. When we informed Department management of the omission, they stated they would begin including the appropriate language.

As a result of the issues identified above, we questioned approximately $26,000 in contract payments.

Finally, we identified questionable practices related to a contract that was referred to the Oregon Department of Justice for subsequent investigation.

Procedures for Sponsorships Needed

State rules require employees to use good judgment when spending state funds. Good judgment includes assessing expected benefits to the state for any funds spent. During fiscal years 2008 through 2010, the Department gave 63 sponsorships totaling $157,500 for various events. Individual sponsorships ranged in cost from $100 to $20,000. We judgmentally selected nine of these for review. In one instance, the Department provided $20,000 for the 2009 Affordable Comfort Inc. NW Conference to be a platinum sponsor, the highest category available. In another instance, the Department gave $2,500 to the Oregon Track Club to support sustainability programs during the 2008 US Olympic Trials.

Documentation for the sponsorship did not explain what the sustainability programs were or whether the Department received any benefit.

The sponsorships may have been a good use of state funds, but the Department lacked policies and procedures for evaluating and documenting their benefits. Moreover, the Department had no limits on the amount a single sponsor could receive or the number of requests that could be submitted.

Expenditures Were Generally Well Supported

We reviewed the Department's processes for tracking and approving expenditures. We also tested specific transactions, including small purchase order transaction system (SPOTS), travel, and payroll expenditures.

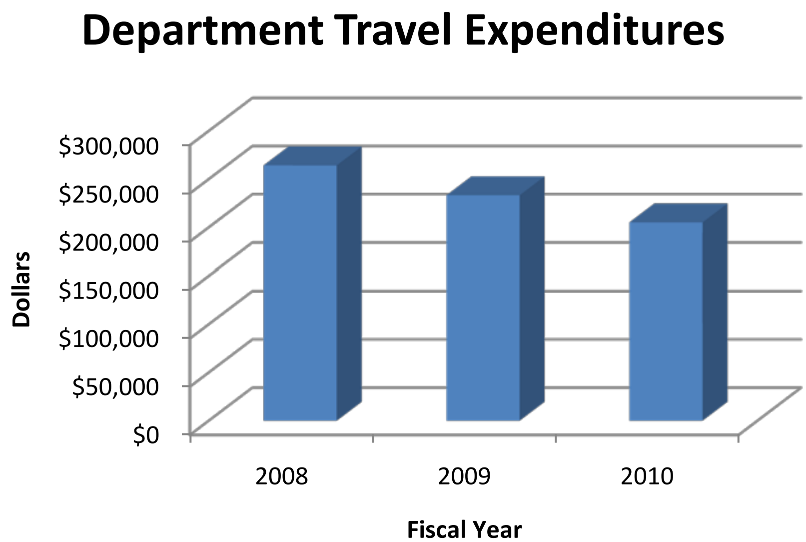
Small Purchases Were Adequately Supported

Agencies are allowed to use SPOTS cards to purchase goods or services that meet agency business needs. The SPOTS card program helps save agencies time and money by reducing the need for purchase orders and petty cash funds. We reviewed a sample of 40 SPOTS purchases and concluded that controls were adequate, with all the expenditures appropriately supported and approved.

Department Reduced Travel Spending and Generally Documented Proper Support for Expenses

Department management told us they had taken actions to reduce travel expenses. For example, they stated they increased requirements for out-of-state travel and reviewed the costs and benefits of using state fleet vehicles assigned to the Department to ensure use was efficient and effective. Our analysis showed that travel expenses declined from $264,000 in fiscal year 2008 to $205,000 in fiscal year 2010, a 22% decrease.

FIGURE 3



During our travel expenditure review, we also tested 20 travel claims totaling approximately $9,350. We found proper documentation and support for the 20 claims, except for $194 for reimbursement claims for meals that had been provided to employees at conferences.

Former Director Continued to Receive Director Level Pay

We reviewed 112 payroll transactions and concluded they were appropriate. However, we noted that the former Director, although moved to a non-director position at the Oregon Business Development Department, remained an employee of the Department for one year in the same position classification and at the same salary of $10,305 per month. The Department also reimbursed a total of about $168,000 in salary and benefits for the Interim Director during this time period.

The May 2009 Department leadership change was accomplished through job rotations. The Governor's Office authorized the former Director's job rotation agreement. A letter from the Governor's Office to the former Director specified the job rotation would be financed by the Department at his same salary and benefit level. The Interim Director was also on a job rotation assigned to the Department from the Department of Consumer and Business Services (DCBS). As part of the agreement, the Department reimbursed DCBS for his payroll expenditures.

Improve Monitoring of Energy Supplier Data

In fiscal year 2010, the Department received about $5.2 million in revenue from energy supplier assessments. The assessments are primarily based on a calculation of annual gross revenues as reported by the energy suppliers. Currently, energy suppliers are assessed 0.069% of the gross revenue they derive in Oregon. Department personnel responsible for monitoring these assessments were able to demonstrate they had some processes in place to help ensure revenues were not underreported. However, the Department takes a risk when it accepts self-reported gross revenue reports, without requiring independent verification. In addition, the Department does not require energy suppliers to use a consistent accounting method for determining their reportable gross revenues. Both of these factors can lead to inconsistencies and potential underreporting of revenues.

Improve Delinquent Account Collection Efforts

The Department's accounts receivable include the energy supplier assessments discussed above, energy facility siting fees and interdepartmental charges for energy programs such as the State Energy Efficiency Design program. The state defines a delinquent receivable as any receivable that is 30 days or more past due. The Department had about $228,000 in receivables outstanding as of April 2010, with about $167,000 or 73% of the amount delinquent.

We reviewed 20 of the delinquent accounts and found that on average they were delinquent for approximately one year. Timely and progressive collection efforts can increase the likelihood of collecting amounts owed. An example of progressive effort is stronger wording in subsequent collection letters to alert debtors to the potential consequences of non-payment, such as turning the account over to a collection agency. Among the 20 delinquent receivables we found:

- Seventeen, totaling about $61,000, which should have been turned over to the Department of Revenue or a collection agency, but were not.
- Nine did not have a collection letter sent to the debtor.
- In instances when the Department sent more than one collection letter, there was no change in the severity of the wording.

We noted that the Department did not have a well-documented and systematic process for pursuing delinquent receivables. Nor did it have written policies and procedures specific to collection activities as required by state rules.

Improve Physical and Electronic Information Security

Our audit work on information security was limited to a review of Department employee access to Department buildings and systems, Department information technology policies, the business continuity plan, information asset classifications, and intergovernmental agreements for developing and housing Department databases.

We determined that Department employees were granted excessive access to Department buildings during non-business hours. The Department modified access to improve physical security after we brought this issue to management's attention. We also found the Department lacked a security incident response plan and needed to complete an updated business continuity plan.

Effective incident response protects the availability, integrity and confidentiality of state information assets. Department management stated they follow state policy for security incidents. However, state policy requires each agency to establish capabilities to respond to security incidents, which at a minimum must include an incident response plan.

Business continuity plans, which incorporate disaster recovery, provide a framework of measures to restore information technology services following an emergency or system disruption. Inordinate delays in restoring critical information technology services after a disaster could result in loss or corruption of critical information important to the Department's operations.

In addition, the Department has four databases housed outside the Department. Intergovernmental agreements with the host agency were unclear as to responsibilities for backing up these databases.

Recommendations

To bolster contracting procedures and controls, the Department should:

- Ensure Department contract evaluators submit a signed statement of independence that discloses any potential personal and professional relationships with contract proposers;
- Consider enhancing the criteria the Department uses to score potential contractors' cost proposals;
- Ensure justification for changes to original contractor evaluation scores is consistently documented and explained;
- Ensure deliverables are clearly defined in contracts;
- Require all changes in sub-contractor hourly rates and other charges to be reviewed and approved by the Department, as well as the general contractor; and
- Ensure all future contracts include False Claims Act provisions.

To ensure the best use of public resources, the Department should:

- Require a written evaluation of the expected benefits of a sponsorship in comparison to its cost; and
- Establish guidelines, limits, and a budget for the sponsorships the Department will promote for a given time period.

To enhance monitoring of self-reported information used for energy supplier assessments:

- Consider requiring energy suppliers to have their self-reported gross revenues independently verified to ensure the reasonableness of reported amounts.

To improve collection procedures for accounts receivable:

- Ensure collection letters are promptly sent to entities with past due accounts, adequate progressive action is taken, and excessively delinquent accounts are turned over to the appropriate entities for collection; and
- Develop internal policies and procedures for the accounts receivable collection process.

To improve physical and electronic information security:

- Develop a security incident response plan and complete an updated business continuity plan; and
- Assign responsibility for and ensure regular back-ups of databases outside of the Department are performed.

Objectives, Scope and Methodology

The purpose of our audit was to review and evaluate the Department's business processes in three areas: contracting and procurement, accounts payable and receivable, and information security. The Department had recently experienced significant change (new managers, a rapid increase in staff, and expanded contracting due to increased federal funding from the American Reinvestment and Recovery Act) and management wanted to ensure it had sound business processes in place.

To achieve our objectives, we interviewed Department personnel, personnel from the Department of Administrative Services (DAS), and state employees who helped complete the DAS review of key central services functions. We also observed processes and reviewed Department documentation, including policies and procedures, contract files and invoices, purchase requisition logs, accounts receivable aging reports, travel records, payroll information including job rotation agreements, and information system access records. We also reviewed state personnel policies, laws and regulations, the Oregon Accounting Manual, and best contracting practices.

We tested key controls and processes. These included a review of agency contracts, compliance with Oregon laws and rules, internal controls (e.g. segregation of duties in key business processes), the appropriateness of expenditures, and data reliability.

We reviewed 21 Department contracts that were in active status at some point during the period July 2008 to March 2010. Payments for the contracts totaled approximately $1.6 million and not-to-exceed contract amounts totaled approximately $3.4 million. Of the 21 contracts, we judgmentally selected 12 contracts that were issued to former Department employees or businesses that employed former Department employees. We selected six additional contracts based on high risk factors, such as large dollar amount and source of funding. We randomly selected the remaining three contracts. We tested the contracts for compliance with state laws and compared them to best contracting practices. We also tested contract payments for compliance with state accounting guidelines.

We reviewed expenditures for small purchase order transaction system (SPOTS) cards, travel, and payroll. Specifically, we tested for proper authorization, appropriateness, accuracy and adequate supporting documentation. For sponsorships, we tested nine judgmentally selected payments totaling $59,800. These came from a population of 63 sponsorship payments, totaling $157,500, made during fiscal years 2008 through 2010. For SPOTS cards expenditures, we selected 40 transactions from a total of 381 that occurred from July 1, 2008 through March 1, 2010. Of the 40 transactions, we judgmentally selected 20 and randomly selected the remaining 20. We also reviewed 20 travel claims totaling approximately $9,350. Of these, we selected six claims because they were associated with the SPOTS card transactions noted above and judgmentally selected an additional 14 travel claims based on high risk items such as meal per diems. For payroll expenditures, we tested all 112 March 2010 expenditures.

We reviewed Department energy supplier assessment calculations for calendar years 2007 and 2008. For accounts receivable, we reviewed outstanding receivables as of April 2010. To assess Department collection activities, we reviewed 10 judgmentally selected and 10 randomly selected delinquent accounts from a total of 92.

We reviewed Department information technology policies, the business continuity plan, information asset classifications, and employee access to Department buildings and systems. Additionally, we reviewed a 2007 information security risk assessment conducted by DAS, and intergovernmental agreements for developing and housing Department databases.

We began our fieldwork in March 2010 and concluded it in August 2010 when the Department of Justice (DOJ) launched an investigation into contracting issues at the Department. At DOJ's request, we refrained from contacting Department employees during the investigation and agreed not to issue our report. As required by auditing standards, we withdrew from further work on the audit to avoid interfering with the investigation. Consequently, we concluded our fieldwork without addressing all risks we had identified. However, we communicated these risks to the Department.

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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Oregon
John A. Kitzhaber, M.D., Governor

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May 26, 2011

Gary Blackmer
Director, Audits Division
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Dear Mr. Blackmer:

This letter is in response to the findings and recommendations made by the Audits Division in the Secretary of State Audit Report *Department of Energy: Strengthen Procedures and Documentation.*

The Oregon Department of Energy (ODOE) generally agrees with the recommendations put forth in the report and has taken steps to respond to each of them. Related to the recommendation to bolster contracting procedures and controls, ODOE elevated the Designated Procurement Officer role to the department's Finance and Operations Manager to ensure stronger management oversight and involvement in contracting activities. This change has lead to a number of other improvements in contracting processes and practices. In direct response to the audit, ODOE now:

- Requires all evaluators to sign a conflict of interest and non-disclosure form;
- Evaluates contract scoring criteria to ensure that the cumulative scores and assigned weighting are aligned with the standards and priorities of the agency;
- Requires written justification from the evaluator for all score changes;
- Verifies that contract deliverables are clearly defined in contracts;
- Ensures that changes in sub-contractor hourly rates are approved by both ODOE and the contractor; and,
- Uses the Secretary of State's False Claims Act provisions language into ODOE's solicitation templates.

Related to the recommendation on the use of public resources, for the 2009-11 biennium, ODOE has established a sponsorship request process that requires department managers to document how proposed sponsorship investments advance the agency's mission, provide measurable benefits to the department, and deliver sufficient value for the investment made. Beginning with the 2011-13 biennium, ODOE will be establishing an outreach plan that identifies key sponsorship investments and a biennial budget for sponsorships.

The report recommended enhanced monitoring of self-reported information provided by energy suppliers. ODOE has been evaluating different options to verify self-reported information, one option is to add a certification by the suppliers' existing third party auditing firms. During the 2009-11 biennium, ODOE established an Energy Supplier Assessment (ESA) stakeholder group to ensure greater levels of transparency and accountability in the ESA process. ODOE plans to discuss options for verifying information reported in a broader conversation with stakeholders about ESA administrative rules and processes. This work will begin following the 2011 legislative session.

The audit report made several recommendations to improve accounts receivables processes. ODOE created an Accounts Receivable Policy (FIN-05) that is modeled after administrative rules governing state collection practices. ODOE has also begun to pursue collections on past due accounts and is making referrals to the Department of Revenue, when appropriate.

In response to the recommendations on physical and electronic security, ODOE has taken the following actions:

- Drafted a security incident response plan and prepared an updated business continuity plan. Both these plans are in the process of being reviewed by the executive sponsor. ODOE anticipates having both of these plans completed and training conducted by the end of the year.
- Initiated a regular process of verifying that databases stored off-site are backed up appropriately and consistently.

Finally, I would like to express appreciation to the audit team who worked on this report for their professionalism throughout this process.

Sincerely,

Bob Repine
Acting Director

c: Dawn Farr, Central Services Administrator, ODOE

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 the Executive, Legislative, and Judicial branches of Oregon government. The division audits all state officers, agencies, boards, and commissions and oversees audits and financial reporting for local governments.

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