



DEPARTMENT OF ENVIRONMENTAL QUALITY

Operational Audit

For the Period July 1, 2013 through June 30, 2019

Cindy Byrd, CPA
State Auditor & Inspector

**Audit Report of the
Department of Environmental Quality**

**For the Period
July 1, 2013 through June 30, 2019**



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October 14, 2020

TO THE DEPARTMENT OF ENVIRONMENTAL QUALITY

We present the audit report of the Department of Environment Quality for the period of July 1, 2013 through June 30, 2019. The goal of the State Auditor and Inspector is to promote accountability and fiscal integrity in state and local government. Maintaining our independence as we provide this service to the taxpayers of Oklahoma is of utmost importance.

We wish to take this opportunity to express our appreciation for the assistance and cooperation extended to our office during our engagement.

This report is a public document pursuant to the Oklahoma Open Records Act (51 O.S. § 24A.1 et seq.), and shall be open to any person for inspection and copying.

Sincerely,

A handwritten signature in blue ink that reads "Cindy Byrd".

CINDY BYRD, CPA
OKLAHOMA STATE AUDITOR & INSPECTOR



Background

The Oklahoma Department of Environmental Quality (DEQ or Agency) was established by the Legislature in 1993 to protect human health, provide quality service to Oklahomans through comprehensive environmental protection and to safeguard the natural environment: air, water, and land. The agency is primarily responsible for the environmental policy of Oklahoma and management programs designed to assist citizens in sustaining a clean, sound environment and to preserve and enhance the natural surroundings.

Oversight is provided by a thirteen-member Environmental Quality Board who are appointed by the Governor and confirmed by the Senate. Each member serves a term of five years.

Board members as of August 2020 are:

James Kinder.....	Chairman
Tracy Hammon	Vice-Chairman
Alexandria Kindrick.....	Board Member
Billy Sims.....	Board Member
David Griesel.....	Board Member
Jan Kunze	Board Member
John Easton	Board Member
Kenneth Hirshey	Board Member
Michel Paque	Board Member
Perry Barton.....	Board Member
Shannon Ferrell	Board Member
Steve Mason.....	Board Member
Tim Munson.....	Board Member

The Agency operates through various departments:

- Office of the Executive Director and related administrative offices, referred to as central management in this report, include upper management such as the executive director, the chief financial officer, legal services, and external affairs
- Administrative Services Division includes the Financial Management Department, which is overseen by the chief financial officer and is responsible for receipting funds and preparing and presenting financial information to the Board
- Other divisions responsible for conducting the main duties of the Agency, including the following divisions that issue licenses or certificates relevant to our objectives:
 - Air Quality Division
 - State Environmental Laboratory Services
 - Water Quality Division
 - Land Protection Division

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The following table summarizes the Agency's sources and uses of funds for fiscal years 2018 and 2019 (July 1, 2017 through June 30, 2019).

Sources and Uses of Funds for FY 2018 and FY 2019

	2018	2019
Sources:		
Licenses, Permits, Fees	\$ 39,825,318	\$ 43,528,626
Federal Reimbursements	20,424,704	26,976,505
Appropriations	4,699,897	6,776,879
Other Sources	520,351	456,374
Total Sources	\$ 65,470,270	\$ 77,738,384
Uses:		
Personnel Services	\$ 44,485,492	\$ 44,675,685
Professional Services	8,013,830	3,798,785
Payments-Local Government - Non-Profits	5,714,051	7,684,391
Misc. Administrative Exp	4,238,856	5,102,151
Loans, Taxes, Other Disbursements	2,012,347	9,459,241
Property, Furniture, Equipment	748,972	1,123,083
Travel	654,213	635,845
Buildings-Purchase, Construction, Renovation	265,736	471,173
Other Expenses	91,739	45,177
	\$ 66,225,236	\$ 72,995,531

Source: Oklahoma statewide accounting system (unaudited, for informational purposes only)

**Scope and
Methodology**

Our audit was conducted in response to 74 O.S. § 212, which requires the State Auditor and Inspector’s office to audit the books and accounts of all state agencies whose duty it is to collect, disburse, or manage funds of the state.

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.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessment of materiality and risk for the period July 1, 2013 through June 30, 2019. Our audit procedures included inquiries of appropriate personnel, inspections of documents and records, and review and analysis of financial data from the statewide accounting system. Further details regarding our methodology are included in Appendix A.

Because of the inherent limitations of an audit, combined with the inherent limitations of internal control, errors or fraud may occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

Internal Control Considerations

The Government Accountability Office (GAO) emphasizes the importance of internal controls at all levels of government entities. Their *Standards for Internal Control*¹ outline the five overarching components of internal control: the control environment, risk assessment, information and communication, monitoring, and detailed control activities. Each of these components includes a subset of principles that are expected to be operating at government entities, and these are listed in Appendix B for your reference.

The *Standards for Internal Control* underscore that an internal control system is effective only when the five components of internal control are effectively operating together in an integrated manner. As required by *Government Auditing Standards*², we have identified the aspects of internal control significant to each audit objective in this engagement and our assessments are detailed in Appendix B.

¹ *Standards for Internal Control in the Federal Government*, or the “Green Book,” sets standards and the overall framework for an effective internal control system in federal agencies and is treated as best practices for other levels of government. Last update 2014, accessible online at <https://www.gao.gov/products/GAO-14-704G>.

² *Government Auditing Standards*, or the “Yellow Book,” also promulgated by the GAO, guides our performance and operational audits. Last version 2018, accessible online at <https://www.gao.gov/products/GAO-18-568G>.

OBJECTIVE I Determine whether the agency's internal control system and control environment are operating effectively in line with *GAO Standards for Internal Control*.

Conclusion The Agency's control environment and internal control system are operating effectively in line with *GAO Standards for Internal Control* for some components, but there are opportunities for improvement in some areas of communication, monitoring, and control activities.

Objective Methodology To accomplish our objective, we performed the following:

- Documented our understanding of the agency-wide components and underlying principles of internal control: control environment, risk assessment, information/communication, and monitoring (outlined further in Appendix B). We analyzed the design of the controls and developed related recommendations. We also considered the results of procedures related to control activities, discussed in more detail in Objective II.
- In relation to the first bullet, we obtained an internal control self-assessment completed by management and assessed the results, along with further discussions and review of documentation to verify and confirm as necessary. We also reviewed the agency's strategic plan and performed other preliminary procedures and analysis as outlined in Appendix A.

FINDINGS AND RECOMMENDATIONS

Communication and Monitoring Risks are High

Repeat Finding

Government Auditing Standards direct us to evaluate agency internal control systems against the Government Accountability Office (GAO) *Standards for Internal Control*. Oklahoma's State-wide Accounting Manual contains similar guidance and requirements for agency management.

Internal control is a process used by management, the agency's board, and other personnel to help the entity achieve its objectives. It includes the plans, methods, policies, and procedures used to fulfill the mission, strategic plan, goals, and objectives. The GAO organizes controls into five components with 17 underlying principles (listed in detail in Appendix B). We assessed 16 of the principles at the Department of Environmental Quality.

Following a finding relating to the control environment and communication in our previous audit report, there have been some improvements made at the Agency. We found that management and the

Board generally encourage integrity and ethical values. We also found that the Agency has an organizational structure that allows for clear internal reporting and has developed an approach for risk management.

However, some principles related to communication, monitoring, and control activities are not effectively operating at every level of the agency. We noted opportunities for the Agency to improve in the following areas:

- Control Activity Principles 10 and 12: Management should design control activities to achieve objectives, respond to risks, and implement control activities through policies. Internal control activities can be improved as discussed at Objective 2, in order to properly respond to identified risks.
- Communication Principles 13 and 14: Management should use and communicate quality information to achieve its objectives.
 - It was reported by agency staff that the various divisions' licensing systems are outdated and are unable to provide quality information that can be used to communicate licensing activity to management or otherwise provide quality information for internal use.
 - Based upon our survey responses and our conversations with staff, communication is lacking between central management and staff, and between various divisions of the agency.
- Monitoring Principles 16 and 17: Management should establish and operate monitoring activities to monitor internal control systems, evaluate the results, and remediate identified deficiencies.
 - While it is central management's stance that the various divisions are responsible for reconciling their licensing activity to deposit records, such reconciliations are not occurring. Management is responsible for establishing and monitoring internal control systems.
 - As stated above, licensing systems are outdated and are unable to provide complete and detailed licensing reports. This impacts the agency's ability to monitor the internal control system and evaluate the results.
 - Due to the lack of reliable data and clear communication already described, management has not addressed the repeat finding discussed beginning on page 7. This indicates identified deficiencies are not necessarily being addressed.

While those charged with governance of DEQ have worked to make improvements in agency-wide control areas, continuing to improve communication and monitoring efforts at all levels of the agency is integral. The GAO Standards *for Internal Control* emphasize: "An internal control system is effective if the five components of internal control are

effectively designed, implemented, and operating, and are operating together in an integrated manner.... If a principle or component is not effective, or the components are not operating together in an integrated manner, then an internal control system cannot be effective.”

Recommendation

In order to meet its objectives and effectively control its operations, the Agency must be able to generate and access quality information, both financial and nonfinancial, that is relevant and reliable. In addition, ongoing monitoring should occur during normal operations and include regular management and supervisory activities and reconciliations.

We recommend that management:

- Update internal licensing systems as needed to produce reports that can be used to communicate and monitor licensing activity. Information systems should provide quality information. Management should ensure that this information is timely, current, accurate, complete, accessible, protected, verifiable, and retained. In addition, management should ensure that licensing information is reviewed and is relevant in supporting internal controls and objectives.
- Communicate relevant information to all personnel so that they can understand and carry out their internal control responsibilities. This includes ensuring communication flows between all levels and divisions of the Agency, and could also require educating employees on the proper expectations for communication (for example, how much information management will provide about their decisions, or how much information one division needs about another’s operations).
- Ensure that ongoing monitoring is built into operations, such as regular supervisory activities and reconciliations. These monitoring activities should be formalized in policies and procedures, including any developments to ensure internal controls for monitoring licensing activity are in place.
- Communicate any deficiencies identified by internal monitoring, or by external reviews such as audits, to the parties responsible for taking corrective action and to the oversight body. Management should also track deficiencies to ensure they are addressed on a timely basis.

Views of Responsible Officials

As funds become available, divisions are updating their licensing systems. DEQ will assess each licensing system to ensure quality

information can be obtained so that the divisions are adequately monitoring the licensing issuance processes.

DEQ will establish a formal reconciliation process within each division with reports being submitted to Finance to ensure adequate controls are in place.

Auditor Response

In addition to making improvements specific to licensing revenues, we urge management to also consider its communication and monitoring practices on an agency-wide level.

OBJECTIVE II

Determine whether an effective process is in place to ensure that licenses or certificates issued are reconciled to funds received, in line with best practices and our previous audit recommendation.

Conclusion

An effective process is not in place to ensure that licenses or certificates issued are reconciled to funds received.

Objective Methodology

To accomplish our objective, we performed the following:

- Documented our understanding of the receipting, licensing, and certification processes. We spoke with managers and staff members in each of the divisions to gain an understanding of their individual processes and the various tracking systems used for receipting and licensing.
- Compared the processes in place to best practices for licensing entities and to the *GAO Standards for Internal Control* that formed the basis of our prior recommendation, and developed related recommendations.

FINDINGS AND RECOMMENDATIONS

Deposits Could Be Incomplete: Licensing Activity Not Reconciled to Funds Received *Repeat Finding*

According to central management, the Financial Management Department is responsible for receiving all revenues and making receipting entries into a system called FileMaker, but ultimately the responsibility falls on the various divisions to ensure funds have been received prior to issuing licenses or certificates. Because there is no such formal, consistent process in place within the divisions, we previously recommended management implement a reconciliation of licensing and certification activity to deposits to ultimately ensure all funds received were deposited.

Various division personnel also reported that their licensing systems are outdated and unable to provide quality information for use in such a reconciliation. Underlying this issue is the need for central management to improve its monitoring actions and ensure these essential controls are in place, as discussed in the previous finding.

Without a reliable reconciliation, errors could be made, either my mistake or intentionally, without detection in the fund receipting process or when issuing a licenses or certification.

Our previous audit report emphasized the importance of an independent reconciliation of division activity records to payments received and deposited. In addition, National State Auditors Association best practices for licensing and permitting processes recommend that licensing agencies “track and oversee the application process to ensure that applications are handled as intended and don’t get lost, and that the *amount of fees collected reconciles to the number of licenses and permits issued*” (emphasis added).

Recommendation

We recommend that central management:

- Update division databases as needed to ensure they can provide complete and reliable licensing and certification information for reconciliation purposes.
- Ensure that the various divisions develop formal processes to ensure that funds have been receipted before licenses or certificates are issued to customers. As stated above, best practices recommend that agencies “track and oversee the application process to ensure that applications are handled as intended and don’t get lost, and that the amount of fees collected reconciles to the number of licenses and permits issued.” Documentation of these reconciliations should be retained for management oversight and audit purposes.
- Given that each division utilizes different tracking systems and have different internal processes, detailed written policies and procedures should be developed for each division.

Views of Responsible Officials

As stated above, DEQ will evaluate each licensing system to ensure quality information can be obtained so that the divisions are adequately monitoring the licensing issuance processes.

While DEQ believes divisions have processes in place to ensure funds have been received prior to licenses being issued, formalized divisional policies and procedures will be established. Formal monthly division reconciliations will be documented and monitored by Finance.

APPENDIX A: Detailed Methodology

In gaining an understanding of the agency and developing our objectives, in addition to routine discussions, surveys, analysis, and research, we performed the following:

- Reviewed revenue, expenditure, and asset-related data from the State-Wide Accounting System and gathered information from agency personnel to assess the related financial processes and trends for any notable risks.
- Reviewed the Agency's written policies and procedures relevant in gaining an understanding of agency operations and in developing our objectives and procedures.
- Reviewed the Agency's HR All Actions Report from the State-Wide Accounting System to assess the changes that had a financial impact during the audit period.
- Reviewed information including agency purchase card reports, acquisitions over \$50,000, and various contracts, to determine whether any significant risks were indicated.
- Reviewed multiple audit reports that were conducted by EPA of the various divisions of the Agency.

APPENDIX B: Internal Control Components and Principles

The table below outlines the components and principles of internal control, identifies those considered significant to our specific objectives in this engagement, and notes whether those principles were found to be operating effectively. For those *not* operating effectively, further discussion and related recommendations are included in the report.

As recommended by *Government Auditing Standards* section 9.32, the full outline of the fundamental components of internal control and their underlying principles is included for your reference.

Internal Control Component/Principle	Significant to Audit Objective I	Operating Effectively?	Significant to Audit Objective II	Operating Effectively?
Control Environment Component – Foundation that provides processes and structure to help an entity set expectations and achieve its objectives.				
1. The oversight body and management should demonstrate a commitment to integrity and ethical values.	✓	Yes		
2. The oversight body should oversee the entity's internal control system.	✓	Yes		
3. Management should establish an organizational structure, assign responsibility, and delegate authority to achieve the entity's objectives.	✓	Yes		
4. Management should demonstrate a commitment to recruit, develop, and retain competent individuals.	✓	Yes		
5. Management should evaluate performance and hold individuals accountable for their internal control responsibilities.	✓	Yes		
Risk Assessment Component – Dynamic process of identifying, analyzing, and managing risks facing the entity.				
6. Management should define objectives clearly to enable the identification of risks and define risk tolerances.	✓	Yes		
7. Management should identify, analyze, and respond to risks related to achieving the defined objectives.	✓	Yes		
8. Management should consider the potential for fraud when identifying, analyzing, and responding to risks.	✓	Yes		
9. Management should identify, analyze, and respond to significant changes that could impact the internal control system.	✓	Yes		

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Control Activities Component – Actions management establishes through policies and procedures to protect against risks.				
10. Management should design control activities to achieve objectives and respond to risks.			✓	No
11. Management should design the entity's information system and related control activities to achieve objectives & respond to risks.				
12. Management should implement control activities through policies.			✓	No
Information and Communication Component – Quality information communicated and used to support the internal control system.				
13. Management should use quality information to achieve the entity's objectives.	✓	No		
14. Management should internally communicate the necessary quality information to achieve the entity's objectives.	✓	No		
15. Management should externally communicate the necessary quality information to achieve the entity's objectives.	✓	Yes		
Monitoring Component – Activities to assess the quality of performance and promptly correct any deficiencies.				
16. Management should establish and operate monitoring activities to monitor the internal control system and evaluate the results.	✓	No		
17. Management should remediate identified internal control deficiencies on a timely basis.	✓	No		

The GAO emphasizes that the five components of internal control must be effectively designed, implemented, and operating, and operating together in an integrated manner, for an internal control system to be effective. They further stress that documentation is a necessary part of an effective internal control system. The level and nature of documentation vary based on the size of the entity and the complexity of the operational processes the entity performs. Documentation is required to demonstrate the design, implementation, and operating effectiveness of an entity's internal control system.

Additional details are available in the GAO Standards for Internal Control or "Green Book," accessible online at <https://www.gao.gov/products/GAO-14-704G>.

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