OPERATIONAL AUDIT

Oklahoma Department of Mines

For the period January 1, 2009 through June 30, 2015

Oklahoma State
Auditor & Inspector
Gary A. Jones, CPA, CFE

Audit Report of the Oklahoma Department of Mines

For the Period January 1, 2009 through June 30, 2015

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Oklahoma State Auditor & Inspector

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December 8, 2015

TO THE OKLAHOMA MINING COMMISSION

This is the audit report of the Oklahoma Department of Mines for the period January 1, 2009 through June 30, 2015. 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,

GARY A. JONES, CPA, CFE
OKLAHOMA STATE AUDITOR & INSPECTOR

Background

The Oklahoma Department of Mines (Agency) enforces and implements various provisions of state and federally-mandated programs in health, safety, mining, and land reclamation practices associated with surface and subsurface mining. The department has programs to 1) safeguard human health and safety; 2) issue permits and inspect all mining operations for land reclamation; 3) minimize environmental impact to land, air, and water quality; and 4) regulate blasting of a mine site. The department also conducts miner courses in first aid, mine safety, and accident prevention through the Oklahoma Miner Training Institute.

Oversight is provided by nine board members (Board) appointed by the governor. Each examiner serves a term of seven years.

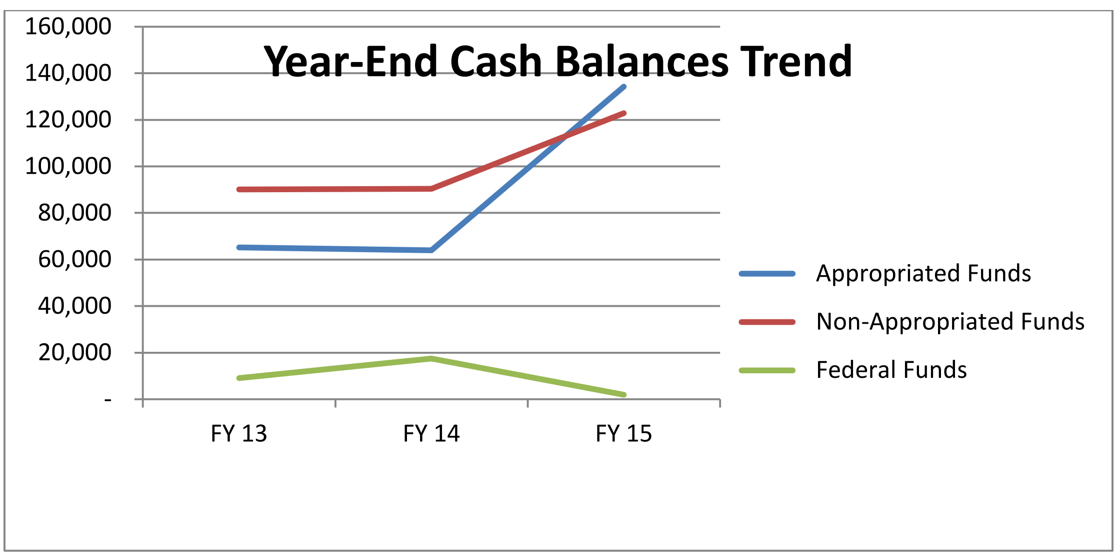
Board members as of June 30, 2015 are:

George Fraley .... Chairman
J. Clement Burdick III. .... Vice Chairman
Ron Cunningham. .... Secretary
Tommy Caldwell .... Member
John Curtis. .... Member
Bill Donoley. .... Member
Kurt Klutts. .... Member
Timothy Lochridge. .... Member
Jed Winters. .... Member

The following information illustrates the Agency's budgeted-to-actual revenues and expenditures and year-end cash balances.[1]

BUDGET TO ACTUAL COMPARISON						
	FY 2014			FY 2015		
REVENUES	**Budgeted**	**Actual**	**Variance**	**Budgeted**	**Actual**	**Variance**
General Appropriations	850,696	879,139	28,443	927,620	878,067	(49,553)
Licenses, Permits, and Fees	949,500	958,861	9,361	964,500	982,447	17,947
Fines, Forfeits and Penalties	89,000	86,811	(2,189)	143,000	35,694	(107,306)
Grants, Refunds and Reimbursements	1,353,000	1,030,214	(322,786)	1,505,825	1,189,540	(316,285)
Non Revenue Receipts	10,500	2,876	(7,624)	9,000	1,799	(7,201)
Total Revenues	**3,252,696**	**2,957,901**	**(294,795)**	**3,549,945**	**3,087,547**	**(462,398)**
EXPENDITURES						
Personnel Services	2,354,082	2,319,203	(34,879)	2,519,267	2,355,876	(163,391)
Professional Services	364,826	301,470	(63,356)	328,950	312,650	(16,300)
Travel Expenses	46,700	48,706	2,006	64,400	46,512	(17,888)
Administrative Expenses	380,180	332,105	(48,075)	395,873	303,670	(92,203)
Property, Furniture, Equipment, and Related Debt	102,000	61,333	(40,667)	154,553	20,450	(134,103)
General Assistance, Awards, Grants, and Other Program-Directed Payments	300	15,000	14,700	250	13,791	13,541
Transfers and Other Disbursements	-	21	21	-	25	25
Total Expenses	**3,248,088**	**3,077,838**	**(170,250)**	**3,463,293**	**3,052,974**	**(410,319)**
Expenditures Over (Under) Revenues		**119,937**			**(34,573)**	

Year-End Cash Balances: FY 13 - FY 15			
	FY 13	**FY 14**	**FY 15**
Appropriated Funds	65,216	64,010	134,316
Non-Appropriated Funds	90,125	90,378	122,853
Federal Funds	9,133	17,399	1,875
Total Available Cash	164,474	171,787	259,044



[1] This information was obtained from the Oklahoma PeopleSoft accounting system. It is for informational purposes only and has not been audited. See summary of management's explanation of variances on page 3 of this report.

Summary of agency responses to budgeted-to-actual variances

This information is a summary of responses obtained from the Oklahoma Department of Mines. It is for informational purposes only and has not been audited. See budgeted-to-actual analysis on page 2 of this report.

Revenues and Expenditures

The agency budgeted in FY14 for an additional $100,000 that was awarded for the Oklahoma Miner Training Institute (OMTI) after the end of FY 14. Additionally, the agency received a larger federal grant award in FY14. The agency expenses were not as high as anticipated; therefore, the federal funds were not drawn in FY14. In FY15, we received full OMTI funding, but again, the funds have been received in the next fiscal year. Additionally, we returned a much larger sum of federal funding due to the fact that state matching funds were not fully available to expend the full federal award. The FY15 award was also decreased; therefore, the amount actually drawn in FY15 was less than expected.

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 duties 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 January 1, 2009 through June 30, 2015. Detailed audit procedures focused on the period of July 1, 2013 through June 30, 2015, addressing the most current financial processes and providing the most relevant and timely recommendations for management.

Our audit procedures included inquiries of appropriate personnel, inspections of documents and records, and observations of the Department of Mines' operations.

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.

OBJECTIVE

Determine whether the Agency's internal controls provide reasonable assurance that revenue, payroll expenditures, and inventory were accurately reported in the accounting records.

Conclusion

The Agency's internal controls do not provide reasonable assurance that revenues, payroll expenditures, and inventory were accurately reported in the accounting records.

FINDINGS AND RECOMMENDATIONS

Inadequate Segregation of Duties over Revenue

The United States Government Accountability Office's (GAO) *Standards for Internal Control in the Federal Government* (2014 Revision)[2] state, "Key duties and responsibilities need to be divided or segregated among different people to reduce the risk of error or fraud. This should include separating the responsibilities for authorizing transactions, processing and recording them, reviewing the transactions, and handling any related assets. No one individual should control all key aspects of a transaction or event."

We identified the following conditions regarding controls over receipts:

- The agency does not have proper segregation of duties related to receipts. Individuals receiving payments and making deposits also have the ability to post payments to accounting records. The account clerk receives payments and creates a "billing record" in PeopleSoft. The Accountant II, prior to preparing and making the deposit, applies payments to those billing records as part of the accounts receivable function.
- The agency does not reconcile actual payments received to permits, licenses, etc. issued. Although there are limited reconciling activities at the program level, those activities are not designed to ensure all payments received have been deposited.

It appears management was not aware of the risks created by inappropriate segregation of duties or lack of appropriate reconciliation controls.

The lack of adequate internal controls provides the opportunity for the receipts to be misstated or misappropriated without detection by either the receptionist/account clerk or the Accountant II as they also have the ability to post payments and deposits to accounting records.

Recommendation

We recommend management segregate duties to ensure the person receiving payments does not have access to post payments received; the person preparing the deposit does not have access to record payments or deposits; and receipts are reconciled to outputs by someone independent of the receipting process and without access to modify deposit records. Documentation of the reconciliation should be maintained.

[2] Although this publication addresses controls in the federal government, this criterion can be treated as best practices. The theory of controls applies uniformly to federal or state government.

Views of Responsible Officials

The agency management believes that adequate controls are in place to assure that the risk of fraud or error are checked and minimized. With a smaller agency, with limited personnel, it can be difficult to have a separation of all duties regarding the receipts and deposits of revenue. Management believes that the procedures in place provide proper assurances. The following procedures are in place.

The Account Clerk receipts all received funds using a pre-numbered receipt. The Account Clerk enters the fees data into the Billing module of Peoplesoft. The Accounts Receivable Accountant accounts for all receipts in sequential order. Each sequentially numbered receipt is accounted for daily. Each receipt is listed on an internally prepared deposit slip that is also numbered in a sequential order. The Accounts Receivable Accountant enters the receipted data into the Accounts Receivable module of Peoplesoft. The Account Clerk does not have security access to the Accounts Receivable module of Peoplesoft. The Accounts Receivable Accountant will record the deposits into the agency maintained ledgers.

The CFO reviews the internally maintained ledgers for all the controls prior to submitting the ledger to OMES for monthly reconciliations. OMES balances the ledgers and reconciling items utilizing agency records and Peoplesoft reports. The CFO reviews and approves the final reconciliations. These are assurances that all funds received are deposited.

Currently, the person receiving payments does not have access to post payments received. The person preparing the deposit does record the deposit. The CFO regularly reviews the internal ledger and the production records. Receipts are not currently reconciled to outputs. The agency will create a reconciliation report to balance the fees received to the outputs (permits) issued. The individual responsible for the permit issuance will not have access to the deposit records.

In addition to developing a reconciliation report, the agency has implemented twice monthly staff meetings to review outstanding production fees. Any operator who is shown to owe production revenue to the agency will receive notifications from the agency. A procedure for the collection of outstanding reports and fees has been implemented. Misstatement or misappropriation of receipts without detection would be difficult with the above controls in place.

Auditor's Response: We do not agree with management's assertion that adequate controls were in place during our audit period. The inherent challenge regarding segregation of duties for smaller agencies is

acknowledged but is typically more relevant for agencies with fewer employees than the Department of Mines. When proper segregation of duties cannot be achieved, it is management's responsibility to design and implement a mitigating control to limit risk.

Based on our testwork, adequate segregation of duties did not exist during the audit period as documented in our finding. In the absence of an adequately designed and implemented mitigating control (such as a reconciliation of revenues received and deposited to outputs), proper segregation of duties is a critical component of providing management, those being regulated, and taxpayers assurance that revenues are being properly safeguarded and accounted for. The OMES Form 11 clearing account reconciliation does not include sufficient detail to provide that assurance.

Inadequate Segregation of Duties over Payroll Expenditures

The GAO *Standards for Internal Control in the Federal Government* state, "Key duties and responsibilities need to be divided or segregated among different people to reduce the risk of error or fraud. This should include separating the responsibilities for authorizing transactions, processing and recording them, reviewing the transactions, and handling any related assets. No one individual should control all key aspects of a transaction or event."

The agency has not adequately segregated key duties related to payroll processes. The CFO currently has the following abilities and duties:

- Modify personnel records as well as payroll data in the PeopleSoft accounting system, such as leave and hours worked. (It should be noted that PeopleSoft will not allow an individual to make changes to their own personnel file.)
- Review and approve payroll claims.
- Serve as the only point of contact with the Office of Management and Enterprise Services – Agency Business Services (OMES-ABS) for payroll. This includes submitting approved personnel/payroll changes for data entry.

It appears management was not aware of the risk created by this arrangement of duties. The agency may also have relied upon the assistance of OMES-ABS to help segregate duties. However, ABS is not closely familiar with payroll hours and changes within the agency and it is ultimately management's responsibility to ensure pay is accurate and appropriate.

The lack of adequate internal controls provides the opportunity for payroll to be misstated or unauthorized payroll and personnel changes to be made without detection.

Recommendation

We recommend management segregate duties to ensure employees responsible for reviewing and approving payroll claims do not have the ability to make changes to payroll or personnel data in PeopleSoft. We also recommend agency management, other than the CFO, periodically independently review payroll claims and supporting documentation to provide assurance that only authorized payroll changes are made. In addition, management may wish to implement a process that would include direct submission of approved payroll/personnel changes to OMES-ABS by the executive director or deputy director. Any review process implemented by the Agency should be documented.

Views of Responsible Officials

ODM will implement an approval process as recommended, requiring an additional payroll and personnel approval by either the Director or Deputy Director of the agency. This approval will include any personnel action or payroll changes that have occurred that month.

While ODM will implement this action, the agency feels confident that proper safeguards have been in place for any payroll or personnel changes as they occurred. ODM changed the payroll procedure recently when the HR position was not filled to assist in cost savings. ODM elected to utilize shared services provided by OMES. ODM entered into a shared service contract with OMES for payroll. The agency contact individual between OMES and ODM is the CFO. The CFO was chosen because of her understanding of payroll functions and her access to the HCM module. All payroll transactions have a source document to authorize OMES to make changes. OMES makes all changes provided by the source documents. As instructed by executive order, all payroll changes (pay increases, promotions or new hires), must be approved prior to payroll changes. These source documents are executed by administrative personnel who include the Agency Director and the appropriate Division Head. These documents are made available to OMES for the authorization of the payroll changes. All these documents will be part of the approval process referenced above.

Auditor's Response: We do not agree with management's assertion that adequate controls were in place during our audit period. In the absence of proper segregation of duties or proper independent oversight and review of payroll transactions, source documents indicating approval of transactions do not on their own provide adequate assurance that only authorized payroll changes are made. The risk remains that the person

who has access, authority, and responsibility for payroll transactions could create fraudulent payroll transactions that would not be detected. This risk will be easily mitigated by implementing an independent review and approval process as indicated in our audit recommendation.

Inadequate Segregation of Duties over Inventory and Inadequate Documentation and Reporting of Inventory Counts – *Repeat Finding*

The GAO *Standards for Internal Control in the Federal Government* state, "Key duties and responsibilities need to be divided or segregated among different people to reduce the risk of error or fraud. This should include separating the responsibilities for authorizing transactions, processing and recording them, reviewing the transactions, and handling any related assets. No one individual should control all key aspects of a transaction or event." The Standards also state that in order to safeguard vulnerable assets, "Such assets should be periodically counted and compared to control records."

In addition, Oklahoma Administrative Code 260:110-3-1 states in part:

> a) **Report due date.** All agencies must submit an annual report of current inventory of tangible assets owned by the agency as of June 30 of the preceding fiscal year to the Office by August 15. The report shall include all tangible assets based upon the threshold stated in 260:110-1-3(a).

We identified the following conditions regarding inventory controls:

- The agency does not have proper segregation of duties related to inventory. All finance employees have access to modify inventory records, which are kept on a shared server. Employees with the ability to initiate purchases, authorize transactions, or process transactions related to inventory should not have access to modify inventory records.
- The agency did not perform physical inventory counts during our audit period.
- The agency is not in compliance with inventory reporting requirements. The last inventory report submitted to the Office of Management Enterprise Services (OMES) was for fiscal year 2012.

It appears management was not aware of the risks created by storing the inventory records on a shared server, and did not have a plan in place to complete inventory counts or submit required reports to OMES when the employee normally responsible for those functions was on leave.

The lack of adequate internal controls provides the opportunity for the inventory to be misstated or misappropriated without detection.

Recommendation

We recommend management segregate duties to ensure no one individual can initiate purchases, authorize transactions, process payments, and modify inventory records. We also recommend management ensure a comprehensive annual physical inventory count is performed and documented by someone independent from purchasing assets, maintaining inventory items and inventory records, and disposing of surplus assets. Management should also ensure required inventory reports are submitted to OMES.

Views of Responsible Officials

ODM will implement new procedures for inventory control. The inventory is contained on the ODM shared drive but will be allowed as a read-only document. The altering of the inventory will be controlled by only two (2) ODM personnel, one being an individual without purchasing authority, and the other the CFO for verification purposes. The following is an outlined procedure.

All additions or deletions of the inventory should occur as new qualifying purchases are made or as property is surplused or discarded in accordance with state procedures. Additionally, a scheduled agency wide update of the agency inventory will be conducted annually. The guidelines are listed below:

- Field office physical inventory will be conducted by two (2) assigned personnel to verify the results. The field office inventory shall be surveyed by January 31 of each year and sent to ODM's Chief Financial Officer (CFO).

- Beginning February 1, the assigned inventory person will be accompanied by an additional assigned departmental employee and through sight verification validates each item on the inventory at the Oklahoma City office.

- The current list of the Oklahoma City inventory will be supplied to the CFO no later than February 15 of each year.

The CFO shall review the inventory lists and then submit a copy of the complete ODM inventory (OKC office, WFO, and field personnel) to the agency director which includes the additions or deletions for the previous year. The list shall also be provided to the Office of Management and Enterprise Services (OMES) in compliance with ODM's annual requirement. The inventory listing will be supplied to OMES on or before the required reporting date.

Auditor's Response:* *Management should also ensure those with responsibility for authorizing or processing transactions related to inventory do not have the ability to modify inventory records.

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