

Date: April 6, 2011

To: Environmental Quality Commission

From: Dick Pedersen, Director

Subject: Agenda item F, Informational item: DEQ's annual financial update
April 21-22, 2011, EQC meeting

Purpose of item DEQ staff will present the agency's annual financial update, review and discuss the report with the commission and gather feedback for improvements to financial reports.

Background The commission has three financial performance measures as part of its 15 best practice measures. These measures require the commission to periodically review key financial information and audit findings, appropriately account for resources and assure that DEQ adheres to accounting rules and other relevant financial controls. An additional key performance measure requires the commission to approve DEQ's biennial budget.

The annual financial report contains audit findings, information on financial monitoring and compliance and additional key financial information for the agency and programs.

EQC involvement DEQ will present budget updates at each regular commission meeting in 2011. DEQ budget and accounting staff will ask the commissioners for feedback on the report's format and content, and any additional financial information they would like to see presented at commission meetings. The commission is responsible for approving and certifying DEQ's budget information.

Attachments A. DEQ's 2011 Annual Financial Update

Approved:

Division: _____

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Department of Environmental Quality

Annual Financial Update to the Environmental Quality Commission

April 21, 2011

Executive Summary

The 2005 legislature directed the Department of Administrative Services and the Legislative Fiscal Office to develop a measure for boards and commissions having governance oversight to use in evaluating their own performance. Because the EQC is included in the Department of Environmental Quality's budget and because it hires DEQ's executive director, DAS and LFO deemed the EQC to have governance oversight and identified it as one of the boards and commissions that should have a performance measure.

On December 14, 2006, the EQC adopted the "percent of total best practices met by the commission" as the performance standard. The measure is an annual self-assessment against 15 best practices for boards and commissions, as laid out by DAS and customized to the EQC.

Three of the 15 best practices are financial management practices measures that rely on the Agency reporting to Commission on a periodic basis. This Annual Financial Update consolidates reporting into a single periodic report that covers audits, on-going compliance, and key financial indicators.

I. Audit Highlights/Summary

The financial audits of 2010 conducted by the Oregon Secretary of State's Office have concluded that the Department's selected financial accounts were fairly stated in accordance with generally accepted accounting principles in relation to the statewide financial statements. Division of Audits also completed the compliance audit of the Clean Water State Revolving Fund (CWSRF). CWSRF is substantially in compliance with federal regulations.

For FY 2010, DEQ internal audit function completed a Small Purchase Order Transaction System review and a follow up review of Oregon Identity Theft Protection Compliance audit within the Vehicle Inspection Program. DEQ is entering into a contract for internal auditing services for FY 2011, 2012 and 2013.

II. State Economic Forecast Summary

The February 2011 update to the Oregon state economic forecast can be found at http://www.oregon.gov/DAS/OEA/economic.shtml#Most_Recent_Forecast, and seems to have finally "bottomed out" in terms of changes in the long term forecast for state General and Lottery Funds. After two rounds of across the board allotment reductions in 2010 that amounted to a total of \$1.4M of general fund reductions for the 2009-11 biennium, general fund revenues for 2009-11 appear to have leveled off, while the continuing reductions in longer term forecasts appear to be slowing down. The next forecast in May 2011 will set the General and Lottery fund levels for balancing the 2011-13 Legislatively Adopted Budget and will be used by the Ways and Means committees to establish agency budgets for the next biennium. Early indications show a Ways and Means co-chairs budget that effectively funds the Governor's Balanced Budget which has previously been presented to the EQC, with a small amount of GF reserved from the budget in year 2 of the biennium. Final actions are still pending, and the Agency will brief the Commission after the Ways and Means work session for our budget.

One recent concern regarding future general fund revenues comes from the tsunami in Japan and the

potential impact to the Oregon economy. The state economist in Washington recently estimated a net negative impact to the state General Fund, impact to the Oregon economy will be evaluated as part of the May 2011 forecast.

The Commission will be regularly briefed on the budget development process for the upcoming biennium, so that information will not be repeated within this report.

III. Internal DEQ Financial Highlights

After two rounds of across the board allotment reductions in 2010 that amounted to a total of \$1.4M of general fund reductions for the 2009-11 biennium, general fund revenues for 2009-11 appear to have leveled off, while the continuing reductions in longer term forecasts appear to be slowing down.

The ongoing recession and jobless recovery continues to have adverse affects on DEQ Fee receipts and weighs on the level of affordable FTE in the Operating Budget. The hardest hit fee funded activities within DEQ, on-site sewage treatment permitting and storm water permitting, are strongly correlated with construction activity and have seen revenues cut by roughly half. Other permitting activity fees have dropped as some facilities have ceased operations and others have reduced outputs, both in terms of economic production and pollutants. The solid waste tipping fees have dropped as consumer, construction, and manufacturing wastes have all declined. In all of these cases, the timing of recovery is uncertain, with a component of not just *when* activity will return to pre-recession levels, but also *if* activity will return to pre-recession levels. All of these impacts were discussed in last years report, and while there have been some improvements since last year, the recent significant drop in new home sales/construction threatens to reverse those improvements in certain areas.

The Key Financial Information indicates that implementation of the budget execution plan for DEQ is on solid ground and the Department's cautionary practices have ensured that finances have been appropriately managed through the first 18 months of the biennium and will continue for a successful close out of the 2009-11 biennium. That assessment doesn't translate directly to program operations, where the ongoing economic uncertainty, reduced fee receipts, and long term shortage of funding at the state level continue to impact the Department's ability to fully deliver its environmental services.

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I. Audits

Detailed audit reports from the Secretary of State's office are sent directly to the Environmental Quality Commission and the DEQ Director at the time of issuance. For those reports already issued, the findings are summarized in this section.

A. Completed Audits

1. Secretary of State Annual Statewide Financial Audit

The Secretary of State annual statewide financial audit for the year ending June 30, 2010 resulted in certification of all audited accounts, with no major findings or reportable conditions.

2. Secretary of State Audit of Capitalization Grants for the Clean Water State Revolving Fund

The Secretary of State federal compliance audit of the Capitalization Grants for the Clean Water State Revolving Fund for the year ended June 30, 2010 state that CWSRF is substantially in compliance with federal regulations.

3. Secretary of State Performance Evaluation Review, to determine if there are audit issues at the Department.

The review was completed with a recommendation to perform an operational audit on Laboratory and NPDES wastewater permits. This operational audit is underway.

4. Secretary of State mandated audit of Ballot Measure 66 Lottery funds for the 2007-09 Biennium.

The audit recommended that DEQ, along with seven other state agencies receiving Measure 66 funds, ensure that interest earned is credited to accounts dedicated to Measure 66 activities, DEQ will work with Dept of Administrative Services (DAS) and Oregon Watershed Enhancement Board (OWEB) to credit interest under the new ballot (BM 76) audit.

5. Environmental Protection Agency (EPA) limited scope review of the Department's administrative and financial practices.

The review disclosed that controls for EPA grants were adequate, the financial management system met applicable Federal regulations, and the required administrative and financial reports were completed accurately and timely. No deficiencies were noted.

6. US EPA, Region 10 – Clean Water State Revolving Fund Oregon Program Evaluation Report and ARRA Semi-Annual Review, State Fiscal Year 2009.

US EPA Region 10 conducted a review of DEQ's Clean Water State Revolving Fund program to evaluate compliance with required elements for the regular capitalization grant and the grant received under the American Recovery and Reinvestment Act of 2009. EPA reviewed six projects including Netarts – Oceanside Sanitary District and the City of Reedsport for the regular capitalization grant, and the Three Sisters Irrigation

District, Clackamas County Service District #1, Metropolitan Wastewater Management Commission and the City of Pendleton for the ARRA grant. EPA also met with DEQ program staff.

EPA's final report identified six required actions that have been addressed by DEQ's CWSRF program. These actions focused on DEQ's environmental review process for projects and ensuring loan recipients comply with new federal requirements under ARRA including Davis-Bacon contract language, Disadvantaged Business Enterprise reporting, and Buy American provisions. DEQ is reviewing all ARRA project contracts to ensure the projects comply with the federal requirements.

7. US EPA, Region 10 – Clean Water State Revolving Fund Oregon ARRA Semi-Annual Program Evaluation Report, State Fiscal Year 2009.

EPA is required under the American Recovery and Reinvestment Act of 2009 to conduct program reviews every six months of states administering ARRA funds. EPA reviewed four projects including the City of St. Helens, Swalley Irrigation District, City of Albany and the City of Milwaukie, and met with DEQ program staff. These projects were reviewed for compliance with ARRA requirements and all other program elements.

EPA's final report identified four required administrative actions. These actions focused on reviewing construction contracts for required DBE and Davis-Bacon language, ensuring adequate documentation to determine compliance with Buy American provisions, and conducting searches for known contractors to verify they were not suspended or debarred. DEQ has followed up on all required actions and provided necessary documentation to EPA

8. US EPA, Region 10 – Clean Water State Revolving Fund Oregon ARRA Semi-Annual Program Evaluation Report, State Fiscal Year 2010.

EPA conducted an ARRA semi-annual review for state fiscal year 2010 and reviewed four projects including the City of Astoria, Central Oregon Irrigation District, Farmers Irrigation District and the City of Scappoose. EPA also met with DEQ program staff to discuss ARRA requirements.

EPA's final report identified five required administrative actions. These actions focused on reviewing construction contracts for required DBE and Davis-Bacon language, ensuring adequate documentation to determine compliance with Buy American provisions, and conducting searches for known contractors to verify they were not suspended or debarred. DEQ is following up on all required actions and is working with EPA to ensure the necessary documentation is provided. DEQ expects this to be completed by April 30, 2011.

9. US EPA Office of Inspector General – American Recovery and Reinvestment Act Site Visit of the Denver Street Storage Project, City of Astoria, Oregon..

EPA's Office of Inspector General conducted an unannounced site visit to the City of

Astoria, and evaluated the Denver Street Storage project to assess compliance with ARRA requirements. EPA interviewed city staff and contractor personnel during their site visit and reviewed documents related to ARRA requirements. EPA Office of Inspector General staff also had several discussions with EPA Region 10, DEQ, and the City of Astoria regarding the preliminary findings.

EPA's OIG staff determined the city complied with the Buy American, Davis-Bacon Act, and funding requirements under ARRA, although the final report identified two findings pertaining to the number of jobs created or retained with ARRA funds and one of the four contracts awarded by the city included a change order that did not meet applicable state procurement requirements. DEQ worked with the City of Astoria to submit corrected reports and DEQ has followed up with appropriate action to maintain the documentation. As recommended in the final report, DEQ has disallowed \$57,346 in costs incurred by the city because these costs did not meet applicable Oregon procurement requirements. DEQ and the City of Astoria have addressed the findings and EPA Region 10 is preparing a response to this audit.

B. Audits Currently Underway

1. Secretary of State Opinion Audit of Financial Statements and Internal Controls for Capitalization Grants for the Clean Water State Revolving Fund for FY2010.
2. Secretary of State operational audit to determine if the laboratory is meeting customer needs in a timely manner, assessing whether the laboratory is operating efficiently and maximizing its capacity, and assessing the progress of reducing ONPDES wastewater permit backlog.

C. Audit Plan for FY2012 and Beyond

1. **Secretary of State Annual Statewide Financial Audit for the year ending June 30, 2011.** Audits all financial accounts.
2. **Secretary of State Audit Capitalization Grants for the Clean Water State Revolving Fund for FY 2011.**
3. **Secretary of State Opinion Audit of Financial Statements and Internal Controls for Capitalizations Grants for the Clean Water State Revolving Fund for 2011.**
4. **Secretary of State mandated audit of Ballot Measure 66 Lottery funds for the 2009-11 biennium.** FY2012.
5. **DEQ Internal Audits.** DEQ is entering onto a contract for internal audit services to meet minimum internal audit requirements under [House Bill 3139](#) and [OAR 125-700](#) for FY 2011, FY 2012 and FY 2013. Minimum requirements include:

- One enterprise-wide risk assessment
- At least one audit plan per fiscal year
- At least one risk-based audit per fiscal year
- One SPOTS audit per year
- Any required follow-up audits

II. Compliance and Monitoring

In the execution of its daily financial operations and on-going financial planning and control, DEQ:

- Employs adequate internal controls such as segregation of duties, signature authority processes, graduated procurement authorization, determination of affordability prior to filling positions, etc.;
- Monitors all relevant state and federal accounting requirements to ensure on-going compliance;
- Accounts at fund levels consistent with statutory limits;
- Employs detailed cost and time accounting systems to capture staff time and related costs; and
- Monitors actual costs against legislative adopted budget and operating budget plans.

The results of these efforts on an Agency wide basis are contained in the detailed audit reports sent to the EQC and summarized in the Audit section of this report. The monitoring to assess the financial management controls and health of the subprogram units is summarized in the Key Financial Information section of this report.

III. Key Financial Information

As discussed in the Compliance and Monitoring section, the department uses numerous accounting and cash management tools to manage the day-to-day financial operations of the agency. For longer term financial planning, usually tied to the state biennial budget period, the department uses two principal tools for planning and executing the budgets: the Operating Budget and periodic forecasts.

The Operating Budget is DEQ's budget execution plan, prepared at the beginning of the biennium by updating the Legislatively Approved Budget with current revenue and cost estimates, assessing the planned workload in each activity, and calculating the surplus or deficit in funding balances expected at the end of the biennium. For activities that are estimate to run a deficit ending balance, or have a positive ending balance that is significantly below that required for ongoing cash management requirements, the program then adjusts the Operating Budget to try to bring ending balances back into alignment. Adjustments can include:

- Reallocating fungible general fund or federal grant funds between activities
- Shifting staff assignments out of underfunded activities and into activities with available funding
- Identifying positions that must be maintained vacant for the all or part of the biennium
- Revising/reducing planned capital outlay and contract expenditures
- In extreme cases, laying off staff

Following completion of the Operating Budget, the department develops a forecast every six months to continue monitoring execution of the budget. These forecasts combine the detailed, actual to date spending and revenues with a forecast for the remainder of the biennium. The forecast updates projected staffing levels and other spending plans, followed by another round of adjustments or mid course corrections to bring each activity into alignment with desired ending fund balances. The department prepares more frequent forecast updates (every three months) for those activities requiring corrective actions.

This schedule means that the key financial information presented in this section will vary depending on the year of the report. The first report of the biennium, delivered in even numbered years, provides a summary of the department's Operating Budget execution plan. The second report, delivered in odd numbered years, covers the forecast 18 months into the current biennium.

This report covers the actual performance for the 2009-11 biennium, as determined by the 18months forecast, which uses actual revenue and spending compared to the Operating Budget execution plan developed earlier in the biennium.

For each program unit within DEQ, the report presents the forecasted end of biennium balance and provides a stoplight chart assessment of each subprogram unit, rating the financial status of the unit:

- a. green (good)
- b. yellow (caution)

c. red (danger, requires action)

The stoplight ratings help alert management to activities requiring extra attention, and DEQ procedure is to increase monitoring frequency on red rated subprogram units, including forecasts every 3 months instead of the usual 6-month interval. The stoplight chart presentation also numerically assess the impact of forecast ending balance on the Agency's ability to execute the proposed budget for the subsequent biennium, to provide a longer term assessment beyond the end of the current biennium.

While an operating subprogram forecasted to have a deficit is always cautionary, some of DEQ's activities that are fully funded by fees or other funds must maintain minimum balances for cash management purposes. In those cases, an operating subprogram that is forecast to have a positive cash balance at the end of the biennium may still been assessed as yellow (caution) or red (requires action) if that positive balance is insufficient to meet ongoing cash management needs in the 2009-11 biennium

For all of the reports, variance data is presented from a financial framework, with negative variances being financially bad, and positive variances being financially good. The key financial information makes no attempt to assess the programmatic impacts of the financial results – having key positions vacant may create a positive financial variance in the report but may also have a negative impact on the unit's ability to deliver services.

The stoplight charts represent a compromise between too much detail to be readily understood and too much summarization that could mask issues in specific subprogram units. The DEQ subprogram units are constructed around similar activities and funding restrictions, so they represent the largest collection of work that share funding constraints. To increase the key financial information to the program or agency wide summary level risks having one or two large funds with substantial balances giving the appearance that the entire program is healthy, but since those funds can't be used to subsidize units experience financial difficulties, the program or agency summary level presentation will not identify problem areas.

Detailed information can be provided to the commission on any or all of the Subprogram units. The Department also welcomes any suggestion for future changes so that this report can better meet the needs of the commission.

A. Air Quality Forecast Stoplight Chart

	2nd QTR	3rd QTR	4th QTR	5th QTR	6th QTR	7th QTR	09-11 FCST End. Bal.	2011-13 Budget Beg. Bal.	2011-13 Impact
	Current Biennium						Transition		
ACDP Permits	●		●		●		2,250,873	2,336,200	(85,327)
Title V Permits	●		●		●		2,985,683	2,617,497	368,186
Area/Mob OF	●		●		●		328,151	357,546	(29,395)
Area/Mobile GF/FF	●		●		●		-	-	-
Agency-wide Infrastructure	●		●		●		-	-	-
Asbestos	●		●		●		561,224	445,000	116,224
Greenhouse Gas Reporting	●		●		●		290,728	162,656	128,072
Pass Through	●		●		●		-	-	-
Special Federal Grants	●		●		●		-	-	-
Revenue Agreements	●		●		●		-	-	-
Vehicle Inspection	●		●		●		6,446,746	6,295,678	151,068

Subprogram Unit Summaries:

All Operating Subprogram units are currently operating with acceptable financial limits.

B. Water Quality Forecast Stoplight Chart

	2nd QTR	3rd QTR	4th QTR	5th QTR	6th QTR	7th QTR	09-11 FCST End. Bal.	2011-13 Budget Beg. Bal.	2011-13 Impact
	Current Biennium						Transition		
Wastewater Permitting	●		●		●		3,529,277	2,730,336	798,941
WQ Operator Certification	●		●		●		152,944	131,372	21,572
TMDL & Oregon Plan	●		●		●		-		-
WQ Ambient Monitoring	●		●		●		521,224		521,224
MAPS							-		-
WQ Program Support	●		●		●		-	1,318	(1,318)
WQ Data Management	●		●		●		-		-
WQ Standards & Assessments	●		●		●		-		-
Ground Water	●		●		●		-		-
401 Certification-Dredge & Fill	●		●		●		28,105	43,343	(15,238)
401 Certification - Hydro	●		●		●		451,340	169,442	281,898
CW State Revolving Fund Administration	●		●		●		6,173,284	6,964,203	(790,919)
DW Assessments & Implementation	●		●		●		148,039		148,039
On-Site Systems Permitting	●		●		●		185,999	204,898	(18,899)
Underground Injection Control	●		●		●		7,159	37,621	(30,462)
NPS Implementation 319 Grants	●		●		●		229,930		229,930
DW & Laboratory Certification	●		●		●		69,847	31,675	38,172
Receipts Authority	●		●		●		-		-

Subprogram Unit Summaries:

All Operating Subprogram units are currently operating with acceptable financial limits. Underground Injection Control has been rated as yellow, due to smaller than budgeted ending balance and fees continue to be very low, meriting ongoing monitoring.










C. Land Quality Forecast Stoplight Chart

	2nd QTR	3rd QTR	4th QTR	5th QTR	6th QTR	7th QTR	09-11 FCST End. Bal.	2011-13 Budget Beg. Bal.	2011-13 Impact
	Current Biennium						Transition		
Solid Waste	●		●		●		3,592,028	3,465,895	126,133
Hazardous Waste	●		●		●		1,694,659	1,365,370	329,289
Orphans - Industrial	●		●		●		717,989	284,169	433,820
Orphans - Solid Waste	●		●		●		3,333,808	1,628,000	1,705,808
Cleanup - McCormick & Baxter	●		●		●		-	-	-
Cleanup - Dry Cleaners	●		●		●		265,116	200,000	65,116
Cleanup - Non-Dedicated	●		●		●		3,686,398	3,277,643	408,755
Cleanup - Dedicated	●		●		●		3,767,079	3,100,000	667,079
Spills	●		●		●		604,198	603,803	395
Tanks - UST	●		●		●		857,032	800,283	56,749
Tanks - LUST	●		●		●		1,001,715	937,763	63,952
Tanks - Heating Oil	●		●		●		31,147	20,000	11,147
Umatilla Chemical Demilitarization Depot	●		●		●		-	-	-

Subprogram Unit Summaries:

All Operating Subprogram units are currently operating with acceptable financial limits with a small number of yellow rated activities highlighted for ongoing detailed attention to close out the 2009-11 biennium.




D. Cross Program Operating Budget Report

	2nd QTR	3rd QTR	4th QTR	5th QTR	6th QTR	7th QTR	09-11 FCST End. Bal.	2011-13 Budget Beg. Bal.	2011-13 Impact
	Current Biennium						Transition		
Economic Revitalization Team							-	-	-
Tax Credits							195,226	142,169	53,057
Federal Grants							600,478	-	600,478

Subprogram Unit Summaries:

All Operating Subprogram units are currently operating with acceptable financial limits.

E. Agency Management Forecast Stoplight Chart

	2nd QTR	3rd QTR	4th QTR	5th QTR	6th QTR	7th QTR	09-11 FCST End. Bal.	2011-13 Budget Beg. Bal.	2011-13 Impact
	Current Biennium						Transition		
AM Summary							3,221,324	1,781,447	1,439,877

Subprogram Unit Summaries:

The information for Agency Management is provided at the summary level, since indirect revenues are not allocated to each section in Agency Management. Detailed spending analysis is provided in the second section of reports.