



State of Rhode Island and Providence Plantations
Office of Management and Budget
OFFICE OF INTERNAL AUDIT
One Capitol Hill
Providence, Rhode Island 02908-5889
TEL #: (401) 574-8170

March 23, 2017

Ms. Janet Coit
Director
Department of Environmental Management
235 Promenade Street
Providence, RI, 02908

Dear Director Coit:

The Office of Internal Audit has completed its audit of the Department of Environmental Management. The audit was conducted in conformance with the Institute of Internal Auditors (IAA) International Standards for the Professional Practice of Internal Auditing and by the authority given to the unit as stated in accordance with the Rhode Island General Laws (RIGL) §35-7.1-1 – Establishment of office of internal audit. The recommendations included herein have been discussed with members of management, and we considered their comments in the preparation of this report.

RIGL §35-7.1-10 (d), entitled Annual and interim reports, states that, “Within twenty (20) calendar days following the date of issuance of the management response copy of the draft audit report, the head of the department, agency, public body or private entity audited shall respond in writing to each recommendation made in the audit report.” Accordingly, management submitted its response to the audit findings and recommendations on March 23, 2017, and such response is included in this report. Pursuant to this statute, the Office may follow up regarding recommendations included in this report within one year following the date of issuance.

We would like to express our sincere appreciation to the staff of DEM for the cooperation and courtesy extended to the members of our team during the course of this audit.

Respectfully yours,

Michael Sprague, CIA
Deputy Chief

c—Jonathan Womer, Director, Office of Management and Budget
Honorable Daniel DaPonte, Chairperson, Senate Committee on Finance
Honorable Marvin Abney, Chairperson, House Finance Committee
Terrence Maguire, DEM Assistant Director of Finance

Audit Executive Summary

Why the Office of Internal Audit Did This Review

The purpose of this engagement is to determine if Department of Environmental Management's (DEM's) fiscal and grant management processes are being administered efficiently and effectively in accordance with federal requirements, statutes and state procedures, and with adequate controls to ensure safeguarding of assets and accurate reporting.

Background Information

The DEM serves as the agent to the State's natural resources. Its mission is "to protect, restore, and promote the environment to ensure Rhode Island remains a wonderful place to live, visit and raise a family."

The Department initiatives include the following:

- Expand the green economy.
- Act on climate change.
- Promote healthy bay and communities.
- Connect people with nature.
- Lean Government: Delivering quality service.

The management services staff monitors the fiscal grants and generates the federal grant financial reports. The program staff monitors the performance of the projects funded by the federal grants and generates the performance reports.

To Strengthen Controls, the Department of Environmental Management should:

- Consider conducting a Lean event to identify potential improvements to requisition and invoice receipt processes.
- Determine whether vendors should be properly classified as sub-recipients or contractors.
- Improve processes for contract creation, review and approval.
- Ensure compliance with the financial reporting terms of all federal awards.
- Standardize the calculation and posting of indirect costs assessments.
- Update the policies and procedures manual and distribute to divisions.

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Introduction

The Rhode Island Department of Environmental Management (DEM) was created by RIGL §42-17.1-1 to enforce Rhode Island's laws and regulations governing the environment, fish and wildlife recreation and commercial fisheries. The Mission of DEM is "to protect, restore and promote our environment to ensure Rhode Island remains a wonderful place to live, visit and raise a family."

In 2015 Governor Raimondo signed the Lean Government Initiative (LGI) Executive Order with the intent that state agencies would take measures to better serve its customers and work to reduce waste and processing times. As noted on the Rhode Island Office of the Governor's Lean Initiative website, DEM has been a leader in the State's Lean Government Initiative and has embraced the notion of creating a culture of continuous improvement.

DEM is comprised of the Office of Director, Executive Staff and Divisional Management. Within Divisional Management there are three Bureaus:

- Office of the Director
- Bureau of Environmental Protection
- Bureau of Natural Resources

The revised budget for FY 2016 is \$102 million, with \$31 million (30%) derived from federal sources.

Control Environment

DEM has an effective system of financial oversight for federal grants, including strong coordination between program and fiscal staff assigned to administer grants. As noted above, a large portion of the operating budget of the agency comes from federal sources. Therefore, it is critical that strong grant management practices are in place to comply with applicable federal and program regulations. DEM Program staff are responsible for the day-to-day operations to successfully perform the grant objectives. DEM's Office of Management Services designates an accountant to work on each grant. The accountants are responsible for tracking all grant expenditures and revenues, preparing and processing drawdowns of federal funds and preparing and submitting required financial reports. DEM has developed a policy and procedure manual regarding the management of grants received by the Department and the responsibilities of the parties involved. Formal policies and procedures are a key component of a sound internal control environment.

However, it was found that the policy and procedure manual needs to be updated and be more encompassing of requirements relating to Federal grants.¹ Additionally, some areas where controls could be strengthened to improve efficiency and overall grant administration will be identified in the sections to follow. While some of the identified issues are solely pertinent to DEM's grant administration process, other issues have the potential to affect the entirety of DEM operations.

¹For a list of recommended policies and procedures, see Appendix A to this report.

The following sections will identify these issues in detail and provide recommendations to help improve procedures and controls.

Recommendations and Management's Responses

The two issues that follow; *Develop an efficient and effective requisition process*, and *Modify invoice receipt procedures* are not unique to DEM and are faced by many State agencies. Due to the strong culture of continuous improvement at DEM, the Department is in a position to address these issues and develop procedures which could serve as a model to other State agencies.

Develop an Efficient and Effective Requisition Process

Rhode Island's Division of Purchases' (Division) rules and regulations state that no work shall proceed until the issuance of a purchase order or change order approved and issued by the Division. The purchase order serves as the contract between the State and the vendor. The issuance of a requisition and purchase order also encumbers the agency's funds. This encumbrance is a budgetary control to ensure agencies stay within their appropriated budget. The Office of Accounts and Control will not allow an invoice to be paid without an accompanying purchase order.²

DEM is receiving some goods and services without a purchase order in place. In these instances invoices are received from the vendor and the purchase order is created after its receipt in order for the payment to be made. The OIA reviewed payments made for the grants which were selected for testing. In FY 2016 DEM paid 140 invoices for goods and services which were procured utilizing a standard purchase order; 45 (32%) of those invoices were created prior to the issuance of a purchase order.

The creation of a purchase order after the invoice could be due to the fact that the ability to initiate a purchase requisition in the system is not granted to all employees, and, therefore, DEM utilizes a paper-based purchasing requisition request form. As a result, the process is subject to human error, such as misplacing or losing the form or untimely entry into the system. The use of the paper form is an informal policy. There are no written policies and procedures which state the steps necessary to obtain a purchase requisition for DEM staff.

If funds are not properly encumbered as noted above, DEM could be spending outside the bounds of their appropriated budget. Additionally, a contract between the State and the vendor does not exist until a purchase order is accepted. A binding contract helps avoid any potential conflicts. Procurements obtained outside of the proper approval process could potentially not align with the goals of the division, department, or the State.

²This is the requirement unless the purchase meets the criteria stated in *CFO 16-10 Direct Pay Documents (Batch Payments) in RIFANS*, issued by the RI Office of Accounts and Control.

Recommendations:

1. Determine whether it would be cost beneficial to grant more employees access to initiate requisitions in the system and develop a more efficient and effective method to request requisitions. Consider the use of electronic means to document and send requisition requests.
2. Consider conducting a Lean event regarding this process.

Management's Response:

In February, the Office of Management Services hosted three sessions of "Purchasing 101," facilitated by the Office of Purchasing. Over seventy employees of DEM, from all Divisions, attended. The sessions stressed that work is not to begin without an approved Purchase Order, as well as reviewed the State's code of ethics.

The Office of Management Services intends to create a "Purchasing 201" session in the fall of 2017, where we will do a "deeper-dive" into the procurement rules and regulations.

Responsible Party: Terrence Maguire

Anticipated Completion Date: December 2017

Modify Invoice Receipt Procedures

RIGL §42-11.1-5 requires State vendors to be paid within 30 business days of invoice receipt. In order to facilitate compliance with this statute, the Rhode Island Office of Accounts and Control (A&C) requires that invoices be remitted to their office and not the agency which made the purchase. A&C also allows vendors to enter invoices in iSupplier, an electronic module of the State accounting system. This reduces paper and postage, eliminates the need to scan and file documents and speeds the payment process. This requirement was designed to prevent an invoice from being lost or misplaced at an agency and, therefore, not being paid in a timely manner.

In order for an invoice to be processed and paid through the State accounting system, the ordering agency must verify that they have received the good or service through an electronic receiving process. The individual(s) certifying that the agency has received the good or service must either be the direct recipient of the ordered items or have verification from the recipient. After proper receipt has been acknowledged, an invoice will be sent through the established approval hierarchy in the State accounting system.

During fieldwork, it was noted that out of a sample of 25 invoices paid by DEM during FY 2016, only 7 were remitted directly to A&C or via iSupplier. The remaining 18 (72%) were sent to DEM in violation of A&C policy. Out of these 18 invoices, 7 were not paid within 30 working days as required by RIGL §42-11.1-5. When invoices were remitted directly to DEM, a "Payment of Vendor's Invoice" paper request form was used by most, but not all, DEM divisions to document and communicate program approval to the fiscal office. Fiscal staff will not approve invoices for payment prior to program staff approval.

One cause for the noncompliance noted above is that as of June 15, 2016, DEM had State accounting system access for only 21 employees, 11 of whom are administrative employees. The cost of RIFANS

licenses are significant; however, a lack of access for a sufficient number of program staff contributes to inefficiencies as there are physical copies of invoices being hand-delivered between program and fiscal staff. Direct submission of invoices to DEM aids their existing paper-based invoice payment approval process.

With the current process in place, invoices may wait on staff's desks waiting to be submitted for payment, and vendors may get frustrated doing business with the State. Paper-based processes can result in inefficiencies. Additionally, the high volume of paper used does not align with the goals of the State and Department's Green Initiative.

Recommendations:

3. Determine which employees should ideally have access to the system and perform a cost-benefit analysis to determine whether the potential benefits gained from granting additional licenses will outweigh the costs of obtaining those licenses.
4. If it is determined that the costs do outweigh the benefits, create a standardized, electronic process to indicate proper receipt of a good or service. Electronic forms and e-mailed documents are potential means to accomplish this and reduce paper utilization.
5. Consider conducting a Lean event regarding this process.

Management's Response:

The Department structure is that we utilize a central business office, Management Services, for most financial matters. The department is spread throughout the state and most field offices cannot accommodate a staff member to work in RI FANS. In our larger divisions, there is a staff member that can work in RI FANS so that the Requisitions are created and the "receiving" function for invoice payment is done in the divisions and electronically sent to Management Services for final approval. The other divisions submit their requests for Requisitions and invoice payments to Management Services for processing.

DEM would like to conduct a lean event with our Natural Resources divisions with a goal of standardizing the required paperwork needed to submit to Management Services for requisitions and invoice payments with the goal of streamlining this process.

Responsible Party: Lynne Keller

Anticipated Completion Date: September 30, 2017

The following issues are more exclusive to DEM operations:

Improve Sub-recipient and Contractor Determination

The Federal Funding Accountability and Transparency Act (FFATA), signed into law in 2006, requires information about Federal awards to be posted on a single, searchable website that is open for public access. FFATA requires an entity that has received funds directly from the Federal Government to capture and report sub-award and executive compensation data for sub-grants awarded. To comply with these

requirements, a distinction must first be made between sub-recipients and contractors of the entity. Per the DEM grant policy and procedure manual, the Federal Aid Coordinator or the Deputy Chief (when there is no Federal Aid Coordinator employed in the division) is responsible for completing FFATA reporting requirements.

Section 200.331(a) of the Uniform Grant Guidance also requires the inclusion of certain information in sub-recipient agreements, including the Federal Award Identification Number, period of performance, required reports, etc. This section also requires the verification that sub-recipients are audited if they meet certain criteria.

DEM does not have controls in place to ensure a timely and accurate determination of whether an entity receiving federal funds through DEM is a sub-recipient or a contractor. This untimely determination has led to noncompliance with FFATA requirements, and a lack of audit verification.

When asked about the FFATA reporting requirements, DEM staff informed the OIA that they were backlogged on the reporting. Certain divisions stated that the sub-recipient versus contractor determination process had not been completed as of the date of audit testing. As a result, audit reports were not collected from required parties. Failure to report all required sub-awards or reporting inaccurate information decreases the reliability of information provided to awarding agencies and other users of the information. Not communicating pertinent information to sub-recipients may lead to noncompliance with federal regulations by the sub-recipient.

Recommendations:

6. Determine whether vendors should be properly classified as sub-recipients or contractors by utilizing guidance from the OMB Grants Management Office.
7. Ensure compliance with federal regulations regarding sub-recipients, including, but not limited to:
 - the reporting of applicable sub-recipient data in accordance with FFATA requirements,
 - the inclusion of required information in sub-award agreements, and
 - the collection of required sub-recipient audit reports.

Management's Response:

Currently, the Department is utilizing the Office of Management & Budget's "Sub-recipient/Contract Determination Tool" worksheet to identify sub-recipients. The department will amend its Policy and Procedure Manual to include a sub-recipient determination process and a process for the division program staff to ensure compliance with the Federal Funding Accountability and Transparency Act of 2006.

Responsible Party: Lynne Keller

Anticipated Completion Date: September 30, 2017

Improve Contract Process

Best business practices require that contracts be properly reviewed and approved to verify the following:

- The department has the necessary funds to meet the obligations called for in the contract.
- The contract is appropriate and serves the Department's mission and responsibilities.
- The services provided are the most feasible in terms of quality and cost.
- The contract is written in a manner which protects the legal interests of the department.

The appropriate signature authority(ies) must be defined and established, and may depend on the value and type of contract. It must be documented that these authorities have reviewed and approved the contract prior to its execution

The Department has a document approval routing sheet to indicate approval of various documents, including contracts; however, it is either widely unused or not maintained. Seven of eight contract files reviewed (87.5%) did not contain a copy of the DEM document approval routing sheet. Additionally, one contract reviewed contained no signatures, and two contracts were not signed prior to the period of performance (12.5% and 25% error rates, respectively). If contracts are not executed prior to the effective period, there is a potential for vendors to perform work without a legally binding agreements established.

DEM also does not ensure that certain key elements are included in its contracts' language. The following deficiencies were noted during fieldwork:

- Five contracts did not contain dispute resolution procedures.
- Four contracts did not contain a right-to-audit statement.
- Two contracts did not identify the methods or individuals responsible for monitoring contract performance.

An insufficient contract approval process can cause a department to be bound by unfavorable contract terms. If unfavorable contracts are signed, there generally is not a method for recourse, especially if the contract does not contain dispute resolution or termination provisions.

Recommendation:

8. Create a detailed and comprehensive process for contract creation, review, approval and retention.

Management's Response:

In the past, the Department's document approval routing sheet was never intended to be a required process but rather used as guidance. In response to this internal audit Recommendation # 8, the Department will compile a detailed checklist for contract creation, review and approval which can be used as a routing sheet. The Department will also include this process for contract approval in the Policy and Procedure Manual.

Responsible Party: Terrence Maguire and Lynne Keller

Anticipated Completion Date: September 30, 2017

Ensure Timely Grant Reporting

According to OMB Uniform Grant Guidance §200.343, a recipient of federal funds must submit all financial reports required under the grant within 90 days after the grant award expires or is terminated. The awarding agency will review these reports to ensure compliance with the grant terms, as well as to make sure all funds were spent appropriately by the awardee. This level of transparency provides the awarding agency the tools to prevent fraud, waste and abuse.

DEM does not have proper controls in place for all of its awards to ensure timely reporting of financial information. Additionally, financial reports for two of the other awards reviewed (13%) were not submitted on a timely basis.

Responsible financial reporting staff do not always have a system in place which serves as a reminder to complete and submit applicable financial reports. The absence of these systems could lead to noncompliance with the reporting requirements stated in the grant agreements could potentially result in suspended future payments or withheld future awards.

Recommendations:

9. Ensure compliance with the financial reporting terms of all federal awards.

Management's Response:

The Department will update its Policy and Procedure Manual to ensure compliance with the financial reporting terms of all federal grants.

Responsible Party: Lynne Keller

Anticipated Completion Date: September 30, 2017

Standardize Calculation and Posting of Indirect Costs

Grants generally allow an organization to charge an additional amount to a sponsor for "Indirect Costs." This charge is in recognition of the administrative and overhead costs associated with the award, including accounting, purchasing, building maintenance, etc. These charges are generally allowed based on a percentage of funds expended, and must be allocated periodically throughout the award period. Until such time when the indirect costs are recovered from awarded funds, State funds are used to pay for the associated administrative and overhead costs. In FY 2016, DEM had a federally negotiated indirect cost rate of 16% of direct salaries and fringe benefit expenses.

DEM uses manual processes to allocate indirect costs to grants. The procedures for recording indirect costs used by the DEM accountants vary significantly, are inconsistent and are subject to manual error. The OIA found one (1) instance in which indirect costs were incorrectly allocated; however, this was subsequently corrected. Additionally, five (5) out of the seven (7) awards tested recorded indirect cost assessments utilizing different time period basis's throughout FY 2016. For example, within one award indirect costs were calculated over a six-month period for one journal entry and over a three-month period for the subsequent journal entry. This non-standardized process could be susceptible to human error and could cause delays to the posting of indirect costs.

Recommendation:

10. Standardize the calculation and posting of indirect costs assessments (for example, monthly assessment) in the State accounting system.

Management's Response:

DEM has varied start and end dates for their federal grants making it difficult to set a department-wide standard. The Department will add to its Policy and Procedure Manual that all indirect costs that are charged to the federal grants are reconciled at the close of each grant to ensure that the amounts are accurate and correct.

Responsible Party: Lynne Keller

Anticipated Completion Date: September 30, 2017

Update Equipment Inventory

Although the State Fixed Asset Control and Tracking System (FACTS) has a comprehensive list of equipment purchased by DEM, the Office of Accounts and Control's Fixed Asset Unit wants agencies to have additional information not captured in FACTS, such as the exact location of an asset, to help facilitate physical inventories. DEM is currently not maintaining an updated internal inventory of all the equipment purchased, as well as the location of the equipment within the division. Outdated fixed asset information also weakens controls over safeguarding of assets, including, but not limited to, lost, misplaced or misappropriation of assets.

Recommendation:

11. Update the equipment listing at DEM to ensure all equipment that is held by each division in the Department is accounted for to comply with State requirements.

Management's Response:

This is a monumental task that requires time and resources (personnel). The Department has seen a twenty-six percent drop in FTEs over the last dozen years. Because of the numerous locations under DEM's domain, it would take a full-time person assigned exclusively, for many months. Since it would appear that this would be a duplicate list to the FACTS, this currently does not rise to the level of reassigning already limited staff.

Responsible Party: N/A

Anticipated Completion Date: N/A

Update policies and procedures

Policies and procedures must be in place for significant business processes in order to:

- Educate staff on how to achieve the mission and objectives of the department.
- Convey employee performance expectations.
- Address potential sources of risk and create awareness of the need for risk management.
- Facilitate training of new employees.

As noted in the Background section of this report, DEM has a Federal Assistance Grant Coordinator Policies and Procedures manual; however, it is not comprehensive.

Recommendation:

12. Update the existing manual to include the items referenced in Appendix A of this report and distribute to Divisions.

Management's Response:

The Department will update its Policy and Procedure Manual for criteria mentioned in this response to the Internal Audit recommendations that are noted previously.

Responsible Party: Lynne Keller

Anticipated Completion Date: September 30, 2017

Objectives and Scope of Audit

The OIA conducted a limited scope audit of the Rhode Island Department of Environmental Management. The purpose of this engagement was to assess the effectiveness and efficiency of grants management practices and whether they are in accordance with Federal and State requirements, statutes and procedures.

Methodology to Conduct Audit

As part of our audit work, the OIA gained an understanding of existing controls in place at DEM for grants and fiscal management. To address our audit objective, we performed the following:

- Interviewed personnel, including financial management and program staff.
- Researched State and Federal laws and regulations.

- Tested a selection of payment and contracts.
- Reviewed drawdown, indirect costs, matching, equipment retention and financial reporting procedures in accordance with State and Federal requirements.

Appendix A:

List of Recommended Policies and Procedures

To improve efficiencies and strengthen controls, DEM should include the following policies and procedures in their Federal Assistance Grant Coordination Policy and Procedure Manual:

- Sub-recipient determination process.
- A process to ensure compliance with the Federal Funding Accountability and Transparency Act of 2006 (FFATA).
- A process to review sub-recipient audit reports if required
- A process to complete reporting requirements for federal grants.
- A process for contract approval.
- A process for indirect costs calculation.
- Additional procedures related to division recording keeping for fixed assets information to improve safeguarding of assets and meet state and federal requirements.

All updated policies and procedures must be transparent and adequately communicated to DEM staff.