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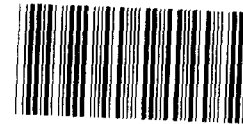
GAO

Report to the Chairman, Committee on
Interior and Insular Affairs, House of
Representatives

February 1988

SURFACE MINING

Interior and State Management of Regulatory Grants



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**Resources, Community, and
Economic Development Division**

B-229954

February 3, 1988

The Honorable Morris K. Udall
Chairman, Committee on Interior
and Insular Affairs
House of Representatives

Dear Mr. Chairman:

Your April 23, 1987, letter requested that we review federal and state management of federal grants annually awarded to states to support their regulatory programs under the Surface Mining Control and Reclamation Act of 1977 (SMCRA). In subsequent discussions with your office, we agreed to focus our review on (1) how the Department of the Interior's Office of Surface Mining Reclamation and Enforcement (OSMRE) ensures that the amount of funds requested by each state is appropriate, (2) whether required audits of the state programs are being performed, and (3) what deficiencies in completed state audits have been reported and, when Interior is the federal agency responsible for ensuring that the deficiencies are addressed, what actions have been taken to correct them.

In summary, we found that

- OSMRE has established a review process for ensuring that state regulatory grant requests are appropriate. OSMRE grant managers review the applications for completeness and accuracy and, in most instances, assess whether the requested funds are needed to carry out the state regulatory program.
- Although the states are generally conducting required audits of their program activities, some are not being completed in a timely manner.
- Completed state grant audit reports have demonstrated numerous deficiencies in the states' internal control systems. Further, in several states independent auditors have questioned or disallowed the costs charged by the states against the grants. For those deficiencies and costs within Interior's jurisdiction, Interior has resolved or is in the process of resolving all of them.

Background

In 1977, the Congress enacted SMCRA to protect society and the environment from the effects of surface coal mining while ensuring the availability of needed coal. SMCRA encouraged the states to assume enforcement responsibility within their borders and authorized OSMRE to

provide annual grants to the states to assist them in developing and carrying out their regulatory programs. Since 1977, OSMRE has provided 26 states with regulatory grants totaling about \$340 million.

Under Attachment P, Audit Requirements, of Office of Management and Budget (OMB) Circular A-102, Uniform Requirements for Assistance to State and Local Governments, and OMB Circular A-128, Audits of State and Local Governments, the states are required to have independent audits of the programs conducted with federal assistance. Rather than requiring audits of each grant individually, the circulars direct an organizationwide audit, that is, a single audit on a statewide or department-by-department basis. OMB also designates a federal agency, referred to as the cognizant federal agency, as having audit responsibility for a particular recipient organization. The cognizant federal agency can vary depending on the state and the scope of audit selected by the state. (App. I provides additional details on the federal audit requirements.)

On October 1, 1986, OSMRE decentralized its management of state grants. Under this structure, OSMRE headquarters prescribes grant management policies and guidelines. These policies are then carried out by grant managers in OSMRE's 13 field offices. The nine field offices east of the Mississippi River report to the Eastern Field Operations Office in Pittsburgh, Pennsylvania, and the four field offices west of the Mississippi River report to the Western Field Operations Office in Denver, Colorado.

OSMRE Generally Following Process for Ensuring Appropriateness of Grant Requests

OSMRE has established a multielement review process for ensuring that state regulatory grant requests are appropriate. Upon receiving a grant request, OSMRE compares the request with prior requests, verifies the internal computations, and checks the application for completeness. We found that these initial reviews are being, and have been, performed by OSMRE grant managers.

Beyond such initial reviews, however, OSMRE's grant manual requires grant managers to examine the individual elements in the request (for example, personnel, equipment, and supplies) for reasonableness of need and cost. This is commonly referred to as a needs assessment. The manual provides general guidance to the grant managers for performing the assessments. It further requires the reviews to be documented.

Although needs assessments, which provide one of the most important bases for determining the appropriateness of the federal grant payment,

have not always been performed, currently they are performed in most cases. Interior's fiscal year 1985 financial integrity review found, in part, that OSMRE's grant managers were generally not performing needs assessments. OSMRE subsequently took steps to improve its performance. In June 1986, it provided training to its grant managers on conducting proper assessments. OSMRE also established in October 1986 an internal control group within the Division of Compliance Management to conduct reviews of field offices' internal control compliance. According to this group's chief, as of September 1987, the group had performed internal control reviews at two field offices. In both locations, the reviews did not disclose any problems with the needs assessments.

Our review of 11 grant applications approved subsequent to the financial integrity review (after October 1, 1986) also found general compliance with the needs assessment requirements. For 8 of the 11 applications, we found documentation demonstrating that the field offices had scrutinized the individual elements of the grant request and had questioned or requested additional information from the state. For example, OSMRE reduced by 9 West Virginia's request to replace 30 vehicles because usage information for existing vehicles did not justify replacing all 30 vehicles. We did not find documentation demonstrating that a needs assessment had been performed in the other three grant files we reviewed. For two of the three files, the responsible grant managers told us that they had reviewed the states' applications for need but did not document their efforts. The other manager responsible for the third grant told us that he had not done the assessment. He said that he had experienced difficulty obtaining requested follow-up information from the state and, as a result, has not been able to perform a needs assessment. Nevertheless, the state's grant request was approved.

As an additional check on field office performance in conducting required needs assessments, the Eastern and Western Field Operations offices have been assigned responsibility for monitoring their respective field office's compliance with OSMRE's grant policies and guidelines. Both offices' grant supervisors told us that their offices were not fully operational when the above grants were processed, but would be expanding their monitoring of the field offices in the coming year.

States Generally Meeting Audit Requirements but Not Always in a Timely Manner

States receiving OSMRE regulatory grant funds are generally complying with federal audit requirements established by OMB.¹ However, some audits are not being submitted in a timely manner. OSMRE awarded regulatory grants totaling about \$156 million to help finance 26 state regulatory programs from 1983 through 1986. Audit reports for 75 of the 98 audit periods covered by these grants have been submitted to the cognizant federal agency and either have been accepted on behalf of the federal government or are currently under review. (See app. II.) Of the remaining 23 audit periods, 8 audits are not yet due or the state has been granted an extension by the cognizant federal agency. The following sections discuss the status of audits for the remaining 15 audit periods. These audits are not being performed in a timely manner, have not been acknowledged as being received by the cognizant federal agency, or have not been performed.

Audits That Are Not Being Performed in a Timely Manner

Audit reports covering eight audit periods have not been submitted to the cognizant federal agency in a timely manner. OMB Circular A-102 does not establish a specific date by which audit reports must be submitted. Instead, it states that audit coverage should be provided in a "timely manner." However, OMB Circular A-128, which superceded Attachment P, Audit Requirements, of A-102, provides that states have up to 12 months from the end of their fiscal year to submit audit reports unless an extension is granted. As of November 1987, four states have not completed seven required audits under A-102 although more than 23 months have elapsed since the end of the applicable fiscal year—West Virginia (fiscal years 1983, 1984, and 1985), Pennsylvania (fiscal years 1984 and 1985), Missouri (fiscal year 1985), and Oklahoma (fiscal year 1985). New Mexico is the only state that did not submit an audit report (fiscal year 1986) within 12 months and did not request an extension, as required under A-128.

State Audit Reports Not Acknowledged as Being Received by the Cognizant Federal Agency

Four states submitted audit reports, covering six periods, that were not acknowledged as being received by the cognizant federal agency. Oklahoma sent an audit report covering two audit periods (fiscal years 1983 and 1984) to the Department of Transportation on June 21, 1985, and, according to a Transportation official, the agency filed the report and took no further action. However, in 1985, Interior was the federal

¹OMB Circular A-128 requires audits to be conducted annually, except where the state constitution or statute requires less frequent audits. Circular A-102, which was superceded by A-128, states that audits will be made annually, but not less frequently than every 2 years.

agency designated to receive audit reports covering the Oklahoma Department of Mines. At the time of our review, Interior did not know that an audit had been performed. Wyoming provided documentation to us showing that a biennial audit report covering two audit periods (fiscal years 1985 and 1986) was submitted to the Environmental Protection Agency (EPA) on May 4, 1987. However, according to an EPA official, the agency had not received the report as of December 1987. Finally, according to an Iowa official and documentation provided to us by Montana officials, the states submitted audit reports for fiscal year 1983 to Interior and the Department of Health and Human Services, respectively. According to an official in each of these agencies, however, the agencies have no record of receiving these reports.

Required Audit Not Performed

Kentucky did not perform an audit for fiscal year 1984. A state official told us that the audit was not performed because, in the middle of the biennial audit cycle, the state changed from a biennial departmental audit to an annual statewide audit. An audit of the Kentucky Department of Natural Resources and Environmental Protection was originally scheduled to cover fiscal years 1984 and 1985; however, when the change occurred, only a fiscal year 1985 statewide audit was performed, leaving 1984 unaudited.

State Internal Control Deficiencies Reported by Independent Auditors

Completed state grant audit reports have demonstrated numerous deficiencies in the states' internal control systems. In several states, the reports also questioned or disallowed a number of costs charged against the OSMRE grants. Although several federal agencies are responsible under the single audit method for ensuring that corrective action is taken to resolve each of these deficiencies, our review covered only those assigned to Interior. We found that Interior has resolved or is in the process of resolving all deficiencies and has questioned or disallowed costs associated with OSMRE grants that have been identified in reports it has received to date.

Systemwide Deficiencies

State audit reports identified many systemwide deficiencies in complying with the various internal control system standards established by OMB for recipients of federal funds. The standards cover such state systems as financial management, property management, and procurement. Twenty-seven of the 44 state audit reports available at Interior reported 53 instances in which the states did not comply with the OMB standards.

Table 1.1 shows the number of times specific deficiencies were identified in these audit reports.

Table 1.1: State Internal Control System Deficiencies

Deficiency	Number of times cited
Accounting systems, including payroll, not in compliance	19
Required financial reports inaccurate or not submitted on time	13
Property management systems, including annual inventories, not in compliance	12
Excess cash on hand	3
Overhead rates not submitted for approval on time	2
Other	4
Total	53

Nineteen of the deficiencies, or almost 36 percent, involved the states' accounting systems. For example, in four states (Alaska, Colorado, Missouri, and Pennsylvania), independent audits found noncompliance with OMB Circular A-87, Cost Principles for Local and State Governments, which requires that payroll charges be supported by time and attendance records for each employee and that these records be supplemented by appropriate time distribution reports. Alaska, for instance, based its salary payments on percentages developed from four 1-week surveys of its employees' time and attendance histories rather than basing its salary payments on actual attendance records.

Questioned or Disallowed Costs

In addition to citing system deficiencies, 9 of the 44 audit reports questioned or disallowed 12 charges totaling about \$3.3 million in costs (about 3 percent of the total grant amounts) charged under OSMRE grants. Although costs were questioned or disallowed in eight states, Pennsylvania and New Mexico accounted for about 90 percent of these costs. (See app. III for the costs questioned or disallowed in each of the eight states.) A Pennsylvania audit report questioned about \$2.7 million of personnel costs charged to the OSMRE grant because the state's payroll system did not comply with the OMB requirement to base payroll charges on employees' actual time and attendance. New Mexico's fiscal year 1985 audit report disallowed \$519,634 of the costs charged against its OSMRE grant. These costs involved inspecting mines on Indian lands, which was not an authorized activity under the state grant.

Resolution of Deficiencies

Although Interior has been assigned responsibility for resolving only a portion of the deficiencies and questioned costs that we reviewed, we found that Interior has in fact resolved all of those for which it is responsible, or is in the process of doing so. To ensure that Interior is taking actions to resolve audit problems, Interior's Inspector General has established a system to monitor relevant actions. Once Interior receives an audit report, the applicable Interior unit must provide the Inspector General with acceptable resolution of the deficiency within 90 days. This resolution can take the form of either a plan of action, including a timetable to correct the deficiency, or documentation demonstrating that corrective action has been taken. For example, to correct two deficiencies—late reports and duplicate charges—Texas developed a tracking system and agreed to deduct the payroll overcharge from its next advance request.

Fifteen of the 53 reported internal control or compliance deficiencies were the responsibility of other federal agencies to resolve and as such were not included in our review. Interior was responsible for resolving the remaining 38 deficiencies and the 12 questioned or disallowed costs associated with the OSMRE regulatory grants. According to the Inspector General's discrepancy tracking system, as of the end of October 1987, 43 of the 50 deficiencies and questioned costs had been resolved to the Inspector General's satisfaction. The proposed resolutions for three of the remaining seven deficiencies were under review by the Inspector General. Responses were not yet due for the remaining four deficiencies.

Conclusions

OSMRE and Interior are generally complying with OMB and agency requirements in their administration of surface mining regulatory grants to the states. With few exceptions, OSMRE grant managers are scrutinizing state grant requests to ensure that the funds requested and ultimately paid to the states are reasonable. Once the funds are granted, required audits of the expenditures are generally being conducted by the states, and deficiencies for which Interior is responsible are being corrected.

Agency Comments

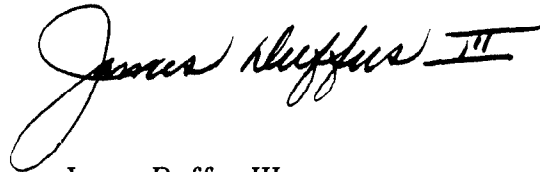
The Department of the Interior was asked for, but did not provide, official agency comments. However, OSMRE program officials stated that they generally agreed with the substance of the report.

We conducted our review from April 1987 through November 1987 in accordance with generally accepted government auditing standards. We reviewed applicable federal grant regulations, policies, and guidelines and interviewed OSMRE headquarters and field office grant management officials and state officials. We also (1) reviewed grant approval procedures and examined grant files, (2) determined the status of required state audits, and (3) reviewed state audit reports and Interior's actions to resolve deficiencies in the reports. More details about the scope of our work are contained in appendix IV.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 15 days from the date of this letter. At that time, we will send copies to the Secretary of the Interior and to the Directors of OSMRE and OMB. Copies will also be made available to others upon request.

Major contributors to this report are listed in appendix V.

Sincerely yours,

A handwritten signature in black ink that reads "James Duffus III". The signature is written in a cursive style with a large, looping initial "J" and a distinct "III" at the end.

James Duffus III
Associate Director

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Abbreviations

EPA	U.S. Environmental Protection Agency
GAO	General Accounting Office
OMB	Office of Management and Budget
OSMRE	Office of Surface Mining Reclamation and Enforcement
SMCRA	Surface Mining Control and Reclamation Act

Federal Audit Requirements

Prior to April 12, 1985, states receiving federal grant funds were required to comply with the federal administrative and audit requirements established by OMB under Circular A-102, Uniform Requirements for Assistance to State and Local Governments. Thereafter, the audit requirements in Circular A-102 were superseded by OMB Circular A-128, Audits of State and Local Governments. Under both OMB circulars, the states are required to have independent audits of the programs conducted with federal assistance. Rather than requiring audits of each grant individually, the circulars direct an organizationwide audit, that is, a single audit on a statewide or department-by-department basis. These independent audits are intended to determine whether the states' financial statements present fairly their financial positions and the results of their financial operations, and provide federal grantor agencies, such as OSMRE, assurance that the states' internal control systems are adequate to ensure that grant funds are spent in accordance with applicable laws and regulations.

The circulars require that, once audit reports are prepared, the states submit them to the federal agency designated by OMB to receive the audit reports on behalf of the federal government.¹ Under both circulars, the cognizant federal agency is responsible for ensuring the completeness of the audit report, the quality of the independent auditors' work, and the acceptable resolution of any problems affecting more than one federal agency. In addition, Circular A-128 makes the cognizant federal agency responsible for ensuring that the audits are performed.

OSMRE grants may represent only a small fraction of total federal grant assistance provided to the state or even to the state agency responsible for conducting the surface mining regulatory function. Accordingly, the OSMRE grant may not be specifically tested for compliance with laws and regulations. However, since these audits are intended to address the soundness of systems for controlling all funds, OSMRE managers need to be aware of deficiencies identified by the audits. Finally, OMB Circular A-128 requires states to provide copies of audit reports to all federal agencies, such as Interior, that provide grant funds to the state in order to improve overall funding controls. Therefore, when the Interior Inspector General receives an audit report, Interior policy is to distribute copies to

¹The cognizant federal agency is the federal agency that is assigned audit responsibility by OMB for each department or agency in each state. For over one half of the states, OMB has also designated one of the cognizant agencies to be the lead agency in representing the interests of the other cognizant agencies with regard to the single audit. In Pennsylvania, for example, the U.S. Department of Agriculture is the lead cognizant agency, while EPA is the cognizant agency for Pennsylvania's Department of Environmental Resources.

each Interior unit (such as OSMRE and the National Park Service) providing funding to the recipient. In addition, deficiencies that Interior is responsible for resolving are entered into the Inspector General's audit deficiency monitoring system.

Status of State Regulatory Grant Audits

	Status of state audit coverage			
	1983	1984	1985	1986
Alabama	X	X	X	X
Alaska	X	X	X	a
Arkansas	X	X	X	X
Colorado	X	X	X	b
Illinois	X	X	b	b
Indiana	X	X	X	a
Iowa	c	X	X	d
Kansas	X	X	X	X
Kentucky	X	e	X	X
Louisiana	X	X	X	X
Maryland	X	X	X	b
Missouri	X	X	f	a
Montana	c	X	X	a
New Mexico	X	X	X	f
North Dakota	X	X	X	X
Ohio	X	X	X	X
Oklahoma	g	g	f	d
Pennsylvania	X	f	f	d
Rhode Island	X	NA	NA	NA
Tennessee	X	X	X	X
Texas	X	X	X	X
Utah	X	X	X	X
Virginia	X	X	X	X
Washington	X	NA	NA	NA
West Virginia	f	f	f	a
Wyoming	X	X	c	c

X - Audit report accepted by the appropriate federal agency.

NA - Not applicable (no regulatory grant awarded for this period).

a - Audit report not due.

b - Under review by cognizant federal agency.

c - According to the state, audit report was sent to the cognizant federal agency. However, the cognizant federal agency has no record of receiving the audit report.

d - Extension granted under OMB Circular A-128.

e - Required audit not performed.

f - Audit not being performed in a timely manner.

g - Audit report sent to the wrong federal agency.

State Costs Questioned or Disallowed by Independent Auditors

State	Fiscal year	Amount	Reason
Alabama	1984-1986	\$19,506	Duplicate costs charged to the grant
		1,995	State did not reimburse OSMRE for sale of property acquired under the grant
Kentucky	1983	3,769	State paid a contractor for an unacceptable report
Missouri	1983-1984	1,349	No documentation of expenditure
New Mexico	1983	1,553	Unauthorized vehicle repairs
New Mexico	1985	519,634	Expenses not authorized under the grant conditions
Ohio	1983-1984	56,716	Cost incurred prior to the grant
		8,866	Improper overhead rate
Pennsylvania	1982-1983	2,676,503	Payroll system did not provide sufficient documentation
		15,301	Lack of documentation for nonpersonnel service expenditures
Texas	1983	59	Payroll overcharge
Virginia	1986	23,147	Cost overstated on financial reports
Total		\$3,328,398	

Scope and Methodology

To determine how OSMRE assures itself that state grant requests are reasonable, we reviewed OSMRE's grant approval procedures and examined grant files for 11 of the 23 grants approved by OSMRE after October 1, 1986. (October 1, 1986, was selected because grants awarded after this date should reflect the implementation of recommendations contained in Interior's 1985 financial integrity review report.) These grants were selected to provide coverage of both large and small grants (representing about 79 percent of OSMRE's fiscal year 1987 grant funds) and the practices followed by 9 of the 13 OSMRE field offices.

To determine whether required audits were being performed, we requested Interior's Inspector General to provide information concerning the audit status of state regulatory grants for fiscal years 1983 through 1986. If a required audit had not been submitted by the state, we contacted the state in question either to verify this fact or to determine the status of the audit.

To determine what deficiencies were reported by the audits, we examined all 44 audit reports for fiscal years 1983 through 1986 that were available at Interior at the time of our review.¹ We then determined the status of the audit discrepancies identified in these reports for which Interior was responsible by reviewing the Inspector General's audit discrepancy tracking system and individual audit files. Our review was limited to Interior's implementation of federal audit requirements.

¹The fiscal year for most of the states covers the period July 1 to June 30. Therefore, grants awarded by OSMRE in one federal fiscal year are used by the states to fund their program in the next fiscal year.

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