

Analysis  
**Department of Environmental Quality**  
Business Operations Report

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**Analyst:** John Terpening

**Request:** Acknowledge receipt of a report from the Department of Environmental Quality on the business operations of the Department.

**Analysis:** The Department of Environmental Quality (DEQ) 2019-21 budget bill, HB 5017 (2019), included the budget note instruction to undertake a comprehensive review of its budget and accounting structure, specifically to contemplate the following:

- 1) Alignment of budget structure and organizational structure
- 2) Alignment of the Department's current use of positions with legislatively authorized positions
- 3) Establishment of distinct budgeted operating areas for dedicated funds
- 4) Assessment of the current cost allocation system and solutions to reduce the number of cost allocations required
- 5) Assessment of the current calculation of indirect rate that funds the Agency Management budgeted division and solutions to provide a more stable funding model
- 6) Application of existing state accounting and budget reporting systems to reduce the reliance on antiquated and cumbersome internal processes.

In accordance with the budget note, the Department submitted their report to the Co-Chairs of the Joint Committee on Ways and Means on January 17, 2020.

The report from DEQ outlines the steps taken thus far, including establishment of a project team that meets weekly to conduct the review, monthly meetings with DAS Chief Financial Office and the Legislative Fiscal Office for consultation, as well as meetings with staff from DAS Financial Business Systems and other state agencies, like the Oregon Health Authority and Department of Agriculture to evaluate other possible methods and options.

As part of the comprehensive review, the Department is first looking at the application of existing state accounting and budget reporting systems. While the Department can currently produce budget reports, they are developed through an antiquated, cumbersome and time-consuming process. By fully utilizing the State's existing budget and accounting system capabilities, DEQ will be able to more quickly and clearly provide financial information for its programs. In conjunction with this effort, DEQ is looking at potential adjustments to its budget and organizational structure that would be reflected in the state systems, which will also help to properly align positions within programs and establishment of distinct budgeted operating areas for dedicated funds. The first of these adjustments will need to take place within the next few weeks in order to be incorporated into the development of the 2021-23 budget.

DEQ has met with other agencies to explore best practices for cost allocation and calculation of indirect rate. The current indirect rate methodology does not provide for stable funding for the Agency Management division as it is based on the personal services costs of other Department

programs for the prior month. Under this methodology, the amount of indirect available to fund Agency Management can be destabilized due to unexpected vacancies within programs. In its continued evaluation of the indirect rate, the Department will need to communicate with the Environmental Protection Agency about any proposed changes as those must be federally approved in order to continue to get federal grant monies.

**Legislative Fiscal Office Recommendation:** Acknowledge receipt of the report with instructions that the Department will return to the September 2020 meeting of the Emergency Board to report on continued progress in addressing the six items outlined in the original budget note.



# Oregon

Kate Brown, Governor

Department of Environmental Quality

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January 17, 2020

The Honorable Senator Betsy Johnson, Co-Chair  
The Honorable Senator Elizabeth Steiner Hayward, Co-Chair  
The Honorable Representative Dan Rayfield, Co-Chair  
Joint Committee on Ways and Means  
900 Court Street NE  
H-178 State Capitol  
Salem, OR 97301-4048

Dear Co-Chairpersons:

## **Nature of this Letter**

The Legislature included four budget notes in DEQ's budget bill during the 2019 legislative session. Budget Note 4 directs the Oregon Department of Environmental Quality (DEQ) to work with the Oregon Department of Administrative Services – Chief Financial Office (DAS CFO) to undertake a comprehensive review of DEQ's accounting and budget structure through the Statewide Financial Management Application (SFMA) and its alignment with the Oregon Budget Information Tracking System (ORBITS). The review covers the following:

1. Alignment of budget structure and organizational structure;
2. Alignment of the Department's current use of positions with legislatively authorized positions;
3. Establishment of distinct budgeted operating areas for dedicated funds;
4. Assessment of the current cost allocation system and solutions to simplify cost allocations;
5. Assessment of how the indirect rate that funds Agency Management is determined, to provide a stable and predictable funding model; and
6. Application of existing state accounting and budget reporting systems to reduce the reliance on complex and cumbersome internal systems and processes.

## **Agency Action**

DEQ has a complex budget with multiple, and at times, unpredictable revenue sources which fund a diverse set of programs implemented at the statewide and regional level. This has made budget reporting complex and has led to confusion with stakeholders and legislators. DEQ will address this complexity and utilize state financial management tools, to create transparency on how agency funds are being spent.

DEQ estimates that developing and implementing new processes and tools for budget activities will take two biennia. This is due to budget intricacies, unfilled budget and financial services positions, the need to balance project work with budget development and routine budget tasks, and state timeframes for changing agency structure in statewide tools such as SFMA and ORBITS.

In response to this budget note, DEQ has created a project team composed of staff who develop and implement the agency's biennial budgets. The team meets weekly to conduct the review required in the budget note, and DEQ meets monthly with DAS CFO and Legislative Fiscal Office (LFO) for consultation. The team meets periodically with the agency's Leadership Team to discuss budget development, implementation and reporting needs.

The team has initiated a comprehensive process to evaluate current practices, identify areas for improvement, and research potential solutions for topics noted in the budget note. Below are key areas of focus for the team:

- **Strengthen Alignment Between Organizational Structure and Budget to Improve Reporting**

In order to serve multiple program needs in multiple geographies, DEQ has a matrix organizational structure, with some managers and staff charging time across programs. As an example, staff in IT and communications teams may be budgeted in one program, but charge their time across multiple programs, depending on the work needed. While DEQ can produce detailed budget reports, they are cumbersome to develop and not readily available to LFO and others to assess the financial health of a program. DEQ recognizes we do not fully utilize existing systems such as the State's Financial Management Application (SFMA) and we are working with DAS and LFO to potentially expand the use of detailed cross references (DCRs) to produce more detailed financial reports of programs. This will provide transparency to stakeholders and the Legislature, which is a critical goal of this project.

- **Update Cost Allocation Model and Agency Indirect Rate**

DEQ uses a complex cost allocation process. Our project team is exploring best practices by other state agencies. To date, DEQ has worked with the Department of Agriculture (ODA) and Oregon Health Authority – Public Health Division (OHA), and will have additional conversations with other agencies. DEQ continues to talk with LFO and DAS regarding potential options for simplifying cost allocations.

DEQ is exploring options to update the agency's methodology for calculating our indirect rate, which is calculated on personal service expenditures from the prior month. This methodology, which has been used by the agency for many years, results in unstable funding for agency management.

DEQ is working with ODA to learn from their agency's experience with its indirect rate, and will continue to explore other methodologies to determine possible changes the agency may need to make. DEQ has also reached out to the U.S. Environmental Protection Agency

(EPA) about the potential for changes to the agency's indirect rate, as EPA will need to approve changes due to federal grant money it gives to DEQ.

- **Reduce the Use of Outdated Accounting and Budget Application Systems**

DEQ uses State of Oregon budget and accounting tools (ORBITS, SFMA, PICS), and also relies on Microsoft Access and Excel tools to analyze data and create agency budget reports. The Microsoft tools do not interface with new – and will not interface with future – agency and enterprise-wide systems, create complexity, take up a lot of staff time and are vulnerable to failure.

DEQ is exploring how it will optimize use of state financial management systems for greater efficiency, effectiveness and transparency. DAS Financial Business Systems staff recently met with DEQ's project team to share ideas with DEQ to better utilize its use of SFMA. DEQ will schedule additional meetings with DAS to better understand optimizing our use of state tools. DEQ has also talked with the ODA and OHA about the tools they use to analyze budget data, and will reach out to other agencies, too.

**Action Requested**

No action requested.

**Legislation Affected**

Conducting the review directed by Budget Note 4 does not require changes to statute or legislation.

Thank you for your consideration.

Sincerely,

A handwritten signature in blue ink, appearing to read "Richard Whitman".

Richard Whitman  
Director