



STATE OF NORTH CAROLINA

DEPARTMENT OF ENVIRONMENT AND NATURAL RESOURCES

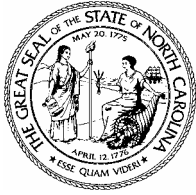
STATEWIDE FINANCIAL AUDIT PROCEDURES

FOR THE YEAR ENDED JUNE 30, 2005

OFFICE OF THE STATE AUDITOR

LESLIE W. MERRITT, JR., CPA, CFP

STATE AUDITOR



STATE OF NORTH CAROLINA
Office of the State Auditor

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March 29, 2006

The Honorable Michael F. Easley, Governor
Members of the North Carolina General Assembly
Mr. William Ross, Secretary
Department of Environment and Natural Resources

We have completed certain audit procedures at the Department of Environment and Natural Resources related to the State of North Carolina reporting entity as presented in the *Comprehensive Annual Financial Report (CAFR)* and *Single Audit Report* for the year ended June 30, 2005. Our audit was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes*.

In the *CAFR*, the State Auditor expresses an opinion on the State's financial statements. In the *Single Audit Report*, the State Auditor presents the results of tests of internal control and compliance with laws, regulations, contracts and grants applicable to the State's financial statements and to its federal financial assistance programs. Our audit procedures were conducted in accordance with auditing standards generally accepted in the United States of America, *Government Auditing Standards* issued by the Comptroller General of the United States and the Single Audit Act as applicable. Our audit scope at the Department of Environment and Natural Resources included the following:

State of North Carolina's Financial Statements

EPA Clean Water Revolving Loan Fund
EPA Drinking Water Revolving Loan Fund

State of North Carolina's Administration of Federal Financial Assistance Programs

Capitalization Grants for Clean Water State Revolving Funds
Capitalization Grants for Drinking Water State Revolving Funds
Nonpoint Source Implementation Grants

Our audit procedures at the Department of Environment and Natural Resources were less in scope than would be necessary to report on the financial statements that relate solely to the Department or its administration of federal programs. Therefore, we do not express such conclusions.

The results of our audit procedures yielded audit findings and recommendations for the Department related to the State's financial statements and federal financial assistance programs that may require disclosure in the aforementioned reports. These findings are included in the findings and recommendations section contained herein. Our recommendations for improvement and management's response follow each finding.

North Carolina General Statutes require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the options listed in the back of this report.

A handwritten signature in black ink that reads "Leslie W. Merritt, Jr." with a stylized flourish at the end.

Leslie W. Merritt, Jr., CPA, CFP
State Auditor

AUDIT FINDINGS AND RECOMMENDATIONS

Matters Related to Financial Reporting or Federal Compliance Objectives

The following findings and recommendations were identified during the current audit and discuss conditions that represent deficiencies in internal control and/or noncompliance with laws, regulations, contracts or grants. Finding number 1 was also reported in the prior year.

1. WEAKNESSES IN CONTROLS OVER CASH RECEIPTS

In our prior audit we noted a number of weaknesses with internal controls over cash receipts. Management has taken action to correct the weaknesses; however, the issues continued to exist during a significant portion of the current audit period. The specific weaknesses are as follows.

- The Division of Environmental Health did not prepare a mail log of checks received through the mail for principal and interest payments for the Drinking Water State Revolving Fund (DWSRF) for a major portion of the year. The Department's Cash Management Plan requires that all cash items received by mail be recorded on a receipt log. The risk that funds received through the mail may not be deposited increases when receipts are not listed on a mail log and reconciled to deposits;
- Controls were not in place to ensure that accounting code sheets were properly prepared for receipts of the Clean Water State Revolving Fund (CWSRF) within the Division of Water Quality. Twelve of 40 accounting code sheets tested had no evidence of preparer and approval to indicate that the deposits were complete and the coding was accurate. The risk of error increases when transactions are not approved.

This finding is resolved. Management has taken action to address the issues noted above. In April 2005, the Division of Environmental Health began recording DWSRF receipts in a mail log. Also the Division of Water Quality implemented procedures to ensure that accounting code sheets were properly prepared for the CWSRF receipts.

2. PROGRESS REPORTS NOT OBTAINED PRIOR TO PAYMENT

The Division of Water Quality did not consistently follow established control procedures when making cash disbursements for its Nonpoint Source Implementation Grants (319 Program). Our examination of 60 disbursements revealed that 10 invoices were approved and paid even though the required quarterly progress reports were not submitted by the subgrantees. The disbursements for the 10 errors totaled \$101,085 and ranged from \$650 to \$27,500. After requesting and obtaining additional documentation from the subgrantees, we were able to determine that the disbursements were for allowable expenditures.

AUDIT FINDINGS AND RECOMMENDATIONS (CONCLUDED)

The 319 Program internal procedures state that invoices will not be approved for payment until the required quarterly progress report has been received, reviewed and approved. The risk of paying for unallowable costs increases when payments are made without reviewing the quarterly progress reports.

Recommendation: The Division of Water Quality should follow established departmental procedures to ensure all 319 Program expenditures are adequately supported prior to making payments.

Agency's Response: Staff in the Division of Water Quality have received training in the proper procedures to follow when processing payments to subgrantees. Established procedures are now being followed.

ORDERING INFORMATION

Audit reports issued by the Office of the State Auditor can be obtained from the web site at www.ncauditor.net. Also, parties may register on the web site to receive automatic email notification whenever reports of interest are issued. Otherwise, copies of audit reports may be obtained by contacting the:

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