



STATE OF NORTH CAROLINA

FISCAL CONTROL AUDIT REPORT ON CLEAN WATER MANAGEMENT TRUST FUND

RALEIGH, NORTH CAROLINA

FOR THE PERIOD JULY 1, 2004, THROUGH JANUARY 31, 2005

OFFICE OF THE STATE AUDITOR

LESLIE W. MERRITT, JR., CPA, CFP

STATE AUDITOR

**FISCAL CONTROL AUDIT REPORT ON
CLEAN WATER MANAGEMENT TRUST FUND
RALEIGH, NORTH CAROLINA
FOR THE PERIOD JULY 1, 2004, THROUGH JANUARY 31, 2005**

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AUDITOR'S TRANSMITTAL

The Honorable Michael F. Easley, Governor
The General Assembly of North Carolina
Board of Trustees, Clean Water Management Trust Fund

This report presents the results of our fiscal control audit of the Clean Water Management Trust Fund for the period July 1, 2004, through January 31, 2005. Our work was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes* and was conducted in accordance with the standards contained in *Government Auditing Standards* issued by the Comptroller General of the United States. The objective of a fiscal control audit is to gather and evaluate evidence about internal control over selected fiscal matters, such as financial accounting and reporting; compliance with finance-related laws, regulations, and provisions of contracts or grant agreements; and/or management of financial resources.

The results of our audit disclosed deficiencies in internal control and/or instances of noncompliance or other matters that are considered reportable under *Government Auditing Standards*. These items are described in the Audit Findings and Recommendations section of this report.

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.

Leslie W. Merritt, Jr.

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

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BACKGROUND INFORMATION

The Clean Water Management Trust Fund (Fund) was established by the General Assembly in 1996. It was the intent of the General Assembly that the money would help to finance projects that specifically addressed water pollution problems and focused on upgrading surface water, eliminating pollution, and protecting and conserving unpolluted surface waters, including urban drinking water supplies. General Statute 113A-253 established the Clean Water Management Trust Fund.

The Fund makes grants to local governments, state agencies and conservation non-profits to help finance projects that specifically address water pollution problems. Its 21 member, independent Board of Trustees has full responsibility over the allocation of moneys from the Fund and hires the executive director. Funded projects must (1) enhance or restore degraded waters, (2) protect unpolluted waters, and/or (3) contribute toward a network of riparian buffers and greenways for environmental, educational and recreational benefits. The primary revenue sources supporting these grants include state appropriations and investment earnings.

The Governor and General Assembly appoint the Board of Trustees. The Fund is an independent agency that is organizationally located for administrative purposes in the Department of Environment and Natural Resources, but exercises its powers independently of the Department. There are 13 permanent positions including the executive director. Twelve of the positions are full-time and one is part-time.

Based on reported amounts and the Fund's website, the Fund received \$62 million in state appropriations from the General Assembly for the fiscal year ended June 30, 2004. The appropriations and the funds remaining from closed grants allowed the Fund to approve 93 water quality grants totaling over \$74 million in calendar year 2004.

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OBJECTIVES, SCOPE, METHODOLOGY, AND RESULTS

OBJECTIVES

As authorized by Article 5A of Chapter 147 of the *North Carolina General Statutes* and in accordance with the standards contained in *Government Auditing Standards* issued by the Comptroller General of the United States, we have conducted a fiscal control audit at the Clean Water Management Trust Fund.

The objective of a fiscal control audit is to gather and evaluate evidence about internal control over selected fiscal matters, such as financial accounting and reporting; compliance with finance-related laws, regulations, and provisions of contracts or grant agreements; and/or management of financial resources. Our audit does not provide a basis for issuing an opinion on internal control, and consequently, we have not issued such an opinion.

Management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that relevant objectives are achieved. Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

SCOPE

Our audit scope covered the period July 1, 2004, through January 31, 2005. During our audit, we considered internal controls related to the following accounts and control objectives.

Grants, State Aid, & Subsidies – These grants may be used to acquire conservation easements, to restore buffers, streams, and wetlands, to prevent stormwater pollution, to plan water quality projects and for administration. The Fund reported grant expenditures during our audit period of approximately \$25.6 million. We examined internal control designed to ensure that the Fund properly accounts for and reports these expenditures, and that the expenditures are made in compliance with the grant agreements and grant criteria.

Travel Expenditures – These expenditures are made for transportation, lodging and meals of employees and Board members who are traveling for their job or Board business. The Fund reported travel expenditures of approximately \$36,800 during our audit period. We examined internal control designed to ensure that the Fund properly accounts for the expenditures, and that the travel expenditures are made in compliance with the State’s Budget Manual.

Cellular Phone Services – These expenditures are incurred by the Fund for cellular phone service by its employees for state business use. The Fund reported cellular phone services expenditures of approximately \$4,300 during our audit period. We examined internal controls designed to ensure that the Fund properly accounts for the expenditures.

Transfers In – These revenues represent state appropriations that are received from the General Assembly and intrafund transfers. The Fund reported transfers in of approximately

OBJECTIVES, SCOPE, METHODOLOGY, AND RESULTS (CONCLUDED)

\$36.5 million during our audit period. We examined internal controls designed to ensure that the Fund properly accounts for these revenues.

As part of our tests of the accounts described above, we reviewed the Fund's control environment. The control environment consists of the actions, policies and procedures that reflect the overall attitude of top management about control and its importance to the agency. As part of these tests we determined if required performance appraisals were performed.

METHODOLOGY

To accomplish our audit objectives, we gained an understanding of internal control, performed tests of control effectiveness, and/or performed direct tests of the accounts and transactions as we considered necessary in the circumstances. Specifically, we performed procedures such as interviewing personnel, observing operations, reviewing policies, analyzing accounting records and examining documentation supporting recorded transactions and balances.

RESULTS

The results of our audit disclosed deficiencies in internal control and/or instances of noncompliance or other matters that are considered reportable under *Government Auditing Standards*. These items are described in the Audit Findings and Recommendations section of this report. We also noted certain other matters that we have reported to management in a separate letter dated June 29, 2005.

AUDIT FINDINGS AND RECOMMENDATIONS

1. REIMBURSEMENT PAYMENTS MADE WITHOUT REQUIRED DOCUMENTATION

The Clean Water Management Trust Fund did not have procedures in place to ensure that grantee reimbursement requests were supported by invoices or other documentation as required by the grant agreements. Our tests of a sample of 48 payments to grantees found that eight did not contain all the necessary documentation to support the payments made. The missing invoices/documentation for the eight errors totaled \$209,962 and ranged from \$1,500 to \$59,500. After we brought this to the Fund's attention, an employee contacted the grantees and obtained the documentation.

The grant agreements between the Fund and the grantees require the grantees to submit invoices and other documentation to support the reimbursement request. Without reviewing the documentation required by the grant agreements, the Fund cannot be sure if the request is allowable per the grant agreement or if the amount requested is accurate.

Recommendation: The Fund should ensure that all the required invoices and other documentation deemed necessary have been received and reviewed prior to making payments to grantees. Balancing procedures should be performed for each request to ensure that all invoices are attached to the request for reimbursement and the total of the invoices agrees to the amount requested.

Agency's Response: CWMTF agrees with this finding. To address this finding, the CWMTF will implement procedures to ensure that required invoices and other documentation deemed necessary have been received and reviewed prior to payment.

2. ACCOUNTING CODE SHEETS NOT REVIEWED

Based upon our review of documentation and tests of internal controls, we found the following weaknesses related to cash disbursements and cash receipts.

- Controls were not in place to ensure that accounting code sheets were properly prepared for cash disbursements. Our examination of a sample of 48 disbursements for grants payments revealed seven cash disbursement accounting code sheets had the same preparer and approver;
- Controls were not in place to ensure that accounting code sheets were properly prepared for operating transfers. Our examination of eight transfers totaling \$801,309 revealed that all had the same preparer and approver.

AUDIT FINDINGS AND RECOMMENDATIONS (CONCLUDED)

Accounting code sheets should be completed properly to indicate that each step of the cash disbursement and cash receipt process has been completed. The risk of inappropriate or misclassified disbursements and receipts increases when transactions are processed without the proper approval. Coding errors could cause the financial statements to be misstated.

Recommendation: The Fund should implement appropriate policies and procedures to ensure accounting code sheets are properly prepared, reviewed and approved. Duties should be segregated so that the same person does not prepare and approve the code sheets.

Agency's Response: CWMTF agrees with this finding. To address this finding, the CWMTF has already implemented procedures to ensure that the accounting code sheets are not prepared and approved by the same person.

DISTRIBUTION OF AUDIT REPORT

In accordance with General Statutes 147-64.5 and 147-64.6(c)(14), copies of this report have been distributed to the public officials listed below. Additional copies are provided to other legislators, state officials, the press and the general public upon request.

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August 26, 2005

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