



STATE OF NORTH CAROLINA

DEPARTMENT OF ENVIRONMENT AND NATURAL RESOURCES

STATEWIDE FINANCIAL STATEMENT AUDIT PROCEDURES

FOR THE YEAR ENDED JUNE 30, 2009

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

DEPARTMENT OF ENVIRONMENT AND NATURAL RESOURCES

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FOR THE YEAR ENDED JUNE 30, 2009

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Office of the State Auditor

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AUDITOR'S TRANSMITTAL

The Honorable Beverly Eaves Perdue, Governor
Members of the North Carolina General Assembly
Mr. Dee A. Freeman, 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, 2009. 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. Our audit procedures were conducted in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*, issued by the Comptroller General of the United States.

Our audit objective was to render an opinion on the State of North Carolina's financial statements and not the Department's financial statements. However, the report included herein is in relation to our audit scope at the Department and not to the State of North Carolina as a whole.

The audit findings referenced in the report are also evaluated to determine their impact on the State's internal control and the State's compliance with rules, regulations, contracts and grants. If determined necessary in accordance with *Government Auditing Standards*, these findings are reported in the State's *Single Audit 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.

A handwritten signature in cursive script that reads "Beth A. Wood".

Beth A. Wood, CPA
State Auditor



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**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN
AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

Secretary Dee A. Freeman
and Management of the Department of Environment and Natural Resources

As part of our audit of the State of North Carolina's financial statements, we have audited selected elements of the Department of Environment and Natural Resources' financial statements, as of and for the year ended June 30, 2009. Our report on the State of North Carolina's financial statements is included in the State's *Comprehensive Annual Financial Report*. Our financial statement audit scope at the Department of Environment and Natural Resources included the EPA Revolving Loan Fund, a major enterprise fund in the State's *CAFR*.

The audit results described below are in relation to our audit scope at the Department and not to the State of North Carolina as a whole.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the State's financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness the Department's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that

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AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN
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a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

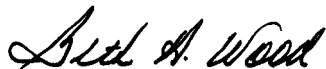
Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State's financial statements are free of material misstatement, we performed tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards* and which is described in the finding in the Audit Findings and Responses section of this report.

Management's response to the finding identified in our audit is included in the Audit Findings and Responses section of this report. We did not audit the response, and accordingly, we express no opinion on the response.

This report is intended solely for the information and use of management, Secretary Dee A. Freeman, others within the entity, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.



Beth A. Wood, CPA
State Auditor

December 8, 2009

AUDIT FINDINGS AND RESPONSES

Matters Not Related to Financial Reporting Objectives

DEFICIENCY IN REPORTING RELATIONSHIP OF INTERNAL AUDITOR

The internal auditor for the Department of Environment and Natural Resources does not report to the Secretary of the agency as required by state law. *North Carolina General Statute* 143-746(d) states “The agency head shall appoint a Director of Internal Auditing who shall report to the agency head and shall not report to any employee subordinate to the agency head.” The purpose of the law is to ensure that internal auditors are as independent as possible in conducting audits.

This finding was reported in the prior year letter to management.

Recommendation: The Department should realign reporting relationships for the internal audit function to correspond to legislative requirements.

Response: The department makes every effort to ensure that internal auditors are as independent as possible in conducting audits. The Secretary and Deputy Secretary review the audit plans and reports developed by the Department Internal Audit Manager. It is made clear to the Internal Audit staff that they are expected to conduct their audit duties independently, and that they are to report any infringement. However, in an effort to more effectively satisfy internal audit independence and meet legislative requirements, effective February 1, 2010 the department’s Internal Audit staff will report to the Office of the Secretary.

Auditor Comment: While the Department’s response recognizes management’s expectation for the internal auditor to maintain their independence, having the internal auditor directly report to someone other than the agency head provides opportunity for the internal auditor’s work to be influenced and increases the risk that their independence could be impaired.

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