



STATE OF NORTH CAROLINA

DEPARTMENT OF ENVIRONMENT AND NATURAL RESOURCES

STATEWIDE FEDERAL COMPLIANCE AUDIT PROCEDURES

FOR THE YEAR ENDED JUNE 30, 2008

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

DEPARTMENT OF ENVIRONMENT AND NATURAL RESOURCES

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AUDITOR'S TRANSMITTAL

The Honorable Beverly E. Perdue
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 *Single Audit Report* for the year ended June 30, 2008. Our audit was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes*.

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 major federal 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.

Our audit objective was to render an opinion on the State of North Carolina's administration of major federal programs and not the Department's administration of major federal programs. 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* or the Single Audit Act, 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 COMPLIANCE WITH REQUIREMENTS
APPLICABLE TO EACH MAJOR PROGRAM AND ON
INTERNAL CONTROL OVER COMPLIANCE**

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

Compliance

As part of our audit of the State of North Carolina's compliance with the types of requirements described in the *OMB Circular A-133 Compliance Supplement* that are applicable to each of its major programs for the year ended June 30, 2008, we have performed audit procedures at the Department of Environment and Natural Resources. Our report on the State of North Carolina's compliance with requirements applicable to each major program and on internal control over compliance in accordance with OMB Circular A-133 is included in the State's *Single Audit Report*. Our federal compliance audit scope at the Department of Environment and Natural Resources included the following:

- CFDA #66.458 - Capitalization Grants for Clean Water State Revolving Funds
- CFDA #66.468 - Capitalization Grants for Drinking Water State Revolving Funds
- CFDA #10.664 - Cooperative Forestry Assistance

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 of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of compliance with those requirements.

**REPORT ON COMPLIANCE WITH REQUIREMENTS
APPLICABLE TO EACH MAJOR PROGRAM AND ON
INTERNAL CONTROL OVER COMPLIANCE (CONTINUED)**

The results of our audit procedures at the Department of Environment and Natural Resources disclosed no instances of noncompliance that are required to be reported in accordance with OMB Circular A-133.

Internal Control Over Compliance

Management is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the entity's internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies.

A control deficiency in an entity's internal control over compliance 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 noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described in the Audit Findings and Responses section of this report to be significant deficiencies.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. We did not consider any of the deficiencies described in the Audit Findings and Responses section of this report to be material weaknesses in relation to our audit scope at the Department.

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

**REPORT ON COMPLIANCE WITH REQUIREMENTS
APPLICABLE TO EACH MAJOR PROGRAM AND ON
INTERNAL CONTROL OVER COMPLIANCE (CONCLUDED)**

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

February 20, 2009

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AUDIT FINDINGS AND RESPONSES

Matters Related to Federal Compliance Objectives

1. INSUFFICIENT DOCUMENTATION FOR COOPERATIVE FORESTRY ASSISTANCE PROGRAM PAYMENTS

We identified deficiencies in the Department's internal controls for processing payments for the Cooperative Forestry Assistance Program. The deficiencies noted increase the risk of noncompliance with federal requirements and for the processing of unauthorized disbursements.

Our examination of 40 disbursements revealed five instances where contracts for consultants were not properly executed for the Agricultural/Forestry Stewardship project. Further discussion with agency personnel indicated that contracts to consultants were not issued for this project. In addition, for these same sample items, we identified five instances where pre-approved contract expenditure report forms were used to process payments to consultants who perform work for the program. Agency personnel indicated that these pre-signed forms are maintained and used by agency staff to expedite the approval process of invoices from consultants.

Federal guidelines require entities receiving federal awards to establish and maintain internal controls designed to reasonably ensure compliance with federal laws, regulations, and program compliance requirements. In addition, departmental rules have been established covering purchasing practices related to contracts that support an adequate control structure.

Federal Award Information: Our audit affected grant awards for the CFA Program #04-DG-11083137-020, #05-DG-11083137-070, #06-DG-11083137-001 and #07-DG-11083137-002.

Recommendation: Management should establish control procedures that include adequate review of invoices and proper execution of contracts in accordance with departmental policy. Departmental policies and procedures should be re-emphasized to staff.

Response: The Department agrees with the finding and has initiated corrective action. Immediately upon learning of the pre-approved expenditure forms, we collected and destroyed all pre-signed forms. Division of Forest Resources (DFR) staff now understands this is not acceptable. We agree that contracts should be in place between the land owners, plan preparation consultants, and DFR. DFR is now working with DENR Purchase and Services to develop the policies, procedures and forms to implement this.

AUDIT FINDINGS AND RESPONSES (CONCLUDED)

We would like to note that there were compensating procedures that prevented incorrect payments.

- o All contractors are certified by DFR.
- o Land owners can only select from the approved contractor list.
- o Rates are established by DFR.
- o Plans are reviewed and approved by DFR personnel prior to payment.

In addition, we requested that the DENR Internal Audit staff review these payments. This review found no instances of improper payments.

2. INADEQUATE SUPERVISORY REVIEW OF FEDERAL REPORTS

The Department's quarterly *SF-269 Financial Status Reports* for the Cooperative Forestry Assistance program are not reviewed by someone independent of the preparer. As a result, there is an increased risk of error in the reports. However, we did not find any actual errors in the reports during our audit.

Federal guidelines require entities receiving federal awards to establish and maintain internal controls designed to reasonably ensure compliance with federal laws, regulations, and program compliance requirements.

Federal Award Information: Our audit includes grant awards #05-DG-11083137-050 and #06-DG-11083137-008.

Recommendation: Management should establish control procedures that provide for adequate management review of federal reports.

Response: The Department agrees with the finding and has initiated corrective action. All SF-269 reports will be reviewed and signed by either the Manager of the Federal Contracts and Grants Section, or the Assistant Controller.

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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