



# STATE OF NORTH CAROLINA

**DEPARTMENT OF ENVIRONMENT AND NATURAL RESOURCES**

**STATEWIDE FEDERAL COMPLIANCE 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**

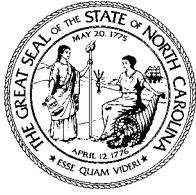
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**Beth A. Wood, CPA**  
State Auditor

STATE OF NORTH CAROLINA  
**Office of the State Auditor**

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**AUDITOR'S TRANSMITTAL**

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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 *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 *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.

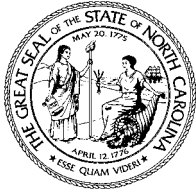
Our audit objective was to render an opinion on the State of North Carolina's administration of major federal programs and not the Department's administration of major federal programs. However, the report included herein is in relation to our audit scope at the Department and not to the State of North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

The audit finding referenced in the report is also evaluated to determine its 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, the finding is 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



**Beth A. Wood, CPA**  
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**REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH  
MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE  
IN ACCORDANCE WITH OMB CIRCULAR A-133**

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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, 2009, 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:

- Capitalization Grants for Clean Water State Revolving Funds (CFDA 66.458)
- Capitalization Grants for Drinking Water State Revolving Funds (CFDA 66.468)

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  
IN ACCORDANCE WITH OMB CIRCULAR A-133 (CONTINUED)**

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The results of our audit procedures at the Department of Environment and Natural Resources disclosed an instance of noncompliance that is required to be reported in accordance with OMB Circular A-133 and which is described in the finding in the Audit Findings and Responses section of this report.

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 a deficiency in internal control over compliance that we consider to be a material weakness.

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 deficiency described in the finding in the Audit Findings and Responses section of this report to be a significant deficiency.

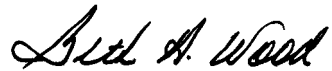
A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. We consider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

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.

**REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH  
MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE  
IN ACCORDANCE WITH OMB CIRCULAR A-133 (CONCLUDED)**

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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

January 15, 2010

## **AUDIT FINDINGS AND RESPONSES**

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### **Matters Related to Federal Compliance Objectives**

#### SUBRECIPIENT AUDIT REPORTS WERE NOT REVIEWED

The Department of Environment and Natural Resources did not review the required audit reports from subrecipients that received capitalization grants from the Clean Water State Revolving Funds (CWSRF) and Drinking Water State Revolving Funds (DWSRF). As a result, the Department did not comply with federal subrecipient monitoring requirements. This increases the risk that federal programs will not be properly administered at the subrecipient level and timely corrective action will not be taken on subrecipient audit findings.

The Department identified 24 local governments that received over \$500,000 in federal funds during the 2008 fiscal year and were to submit an audit report to the Department by March 2009. Our tests of the entire population revealed the following:

- Audit reports were not reviewed for five of the 10 subrecipients that received funds from the CWSRF. During the 2008 fiscal year, the Department disbursed \$11.8 million in federal funds to these subrecipients.
- Audit reports were not reviewed for six of the 14 subrecipients that received funds from the DWSRF. During the 2008 fiscal year, the Department disbursed \$10.6 million in federal funds to these subrecipients.

The *OMB Circular A-133 Compliance Supplement* requires pass-through entities to ensure subrecipients who expend \$500,000 or more in federal awards during the subrecipients' fiscal year have an audit completed within nine months after the end of the subrecipients' audit period. The pass-through entity is also required to issue management decisions on audit findings within six months after the receipt of the subrecipient's audit report and ensure the subrecipient takes timely and appropriate action on all findings.

This control deficiency also increases the risk of noncompliance with federal monitoring requirements applicable to American Recovery and Reinvestment Act (ARRA) funds received by the Department.

*Federal Award Information:* This finding affects the following grants:

- CFDA 66.458 Capitalization Grants For Clean Water State Revolving Funds awards CS-37000104, CS-37000105, CS-37000106, and CS-37000107, and the potential to impact ARRA grant 2W-95421209;
- CFDA 66.468 Capitalization Grants For Drinking Water State Revolving Funds awards FS-98433801, FS-98433802, FS-98433803, FS-98433804, FS-98433805, and FS-98433806; and the potential to impact ARRA grant 2F-95423309-0.

## AUDIT FINDINGS AND RESPONSES (CONCLUDED)

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*Recommendation:* The Department should strengthen its monitoring procedures and tracking system to ensure all required subrecipient audit reports are reviewed and the Department's monitoring procedures are completed in accordance with federal requirements.

*Response:* All required audit reports were submitted on time by the recipients to the department; however, several of these reports were submitted to the Division of Environmental Health (DEH) rather than to the Office of the Controller (OOC). When the OOC became aware of the situation the reports were obtained and reviewed by appropriate personnel in the OOC within two days. No audit findings were found in our review of these reports. The department will continue to ensure compliance with federal requirements.



## **ORDERING INFORMATION**

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Audit reports issued by the Office of the State Auditor can be obtained from the web site at [www.ncauditor.net](http://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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