



# **STATE OF NORTH CAROLINA**

## **DEPARTMENT OF ENVIRONMENT AND NATURAL RESOURCES**

### **STATEWIDE FEDERAL COMPLIANCE AUDIT PROCEDURES**

**FOR THE YEAR ENDED JUNE 30, 2011**

#### **OFFICE OF THE STATE AUDITOR**

**BETH A. WOOD, CPA**

**STATE AUDITOR**

**DEPARTMENT OF ENVIRONMENT AND NATURAL RESOURCES**

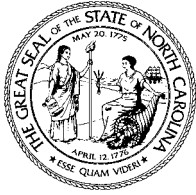
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STATE OF NORTH CAROLINA  
**Office of the State Auditor**

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**AUDITOR'S TRANSMITTAL**

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The Honorable Beverly Eaves Perdue, Governor  
Members of the North Carolina General Assembly  
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, 2011. 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; 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*.

Our audit objective was to render an opinion on the State of North Carolina's, 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 OMB Circular A-133, 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



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

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## **REPORT ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**

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Dee A. Freeman, Secretary  
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 could have a direct and material effect on each of its major programs for the year ended June 30, 2011, 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 that could have a direct and material effect on 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

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 the Department's compliance with those requirements.

The results of our audit procedures at the Department of Environment and Natural Resources disclosed instances of noncompliance that are required to be reported in accordance with OMB Circular A-133 and which are described in findings 1 and 2 in the Audit Findings and Responses section of this report.

**REPORT ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A  
DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON  
INTERNAL CONTROL OVER COMPLIANCE  
IN ACCORDANCE WITH OMB CIRCULAR A-133 (CONCLUDED)**

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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 to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, 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.

*A deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of the internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses, and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. However, we consider the deficiencies described in the findings in the Audit Findings and Responses section of this report to be significant deficiencies in internal control over compliance, as defined above.

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.

This report is intended solely for the information and use of management, Secretary Dee A. Freeman, others within the entity, the Governor, the General Assembly, 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

March 9, 2012

## AUDIT FINDINGS AND RESPONSES

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

#### **1. COMPLETE AWARD INFORMATION NOT CLEARLY COMMUNICATED TO SUBRECIPIENTS**

The Department of Environment and Natural Resources did not ensure that subrecipients were made aware of all identifying federal award information. As a result, the Department did not comply with federal requirements and there is increased risk that federal awards, expenditures and CFDA numbers will not be properly identified in the subrecipient's Schedule of Expenditures of Federal Awards and Data Collection Forms.

The Department uses an Offer and Acceptance Document to award Clean Water and Drinking Water State Revolving Funds to subrecipients. This document identifies the name of the federal program and communicates the federal requirements imposed on subrecipients by federal laws and regulations. However, until it was changed during the audit period, the standard document did not identify the CFDA number or the federal award number.

The Offer and Acceptance Document for Clean Water State Revolving Loan projects was amended on February 7, 2011 to include the CFDA number and the federal award number. The Offer and Acceptance Document for Drinking Water State Revolving Fund projects was amended on June 15, 2011 to include the CFDA number and the federal award number.

OMB Circular A-133 requires pass-through entities to inform each subrecipient at the time of the award of the CFDA title and number, award name and number, the name of the federal funding agency, and the requirements imposed on them by federal laws and regulations.

*Federal Award Information:* This Finding affects CFDA 66.458 Capitalization Grants for Clean Water State Revolving Fund and Federal awards CS-37000107 for the award period July 1, 2007 - December 31, 2012; CS-37000108 for the award period October 1, 2008 - September 30, 2012; CS-37000109 for the award period of April 1, 2009 - March 31, 2012 and CS-37000110 for the award period of September 1, 2010 - September 30, 2012.

The finding also affects CFDA 66.468 Capitalization Grants for Drinking Water State Revolving Funds and Federal awards FS-98433807 for the award period of July 1, 2008 - September 30, 2013; FS-98433808 for the award period of July 1, 2009 - September 14, 2014 and FS-98433809 for the award period of July 1, 2010 - September 14, 2015.

*Recommendation:* As described above, the Department has corrected its award document for new projects. The Department should also make past recipients aware of all award identification information and review its standard documents on an ongoing basis to ensure all required communications are included.

*Agency Response:* Department agrees with the finding. Corrective action was implemented by the Clean Water program on February 7, 2011. Corrective action was implemented by the Drinking Water Program on June 15, 2011.

## AUDIT FINDINGS AND RESPONSES (CONCLUDED)

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### 2. MONITORING OF SUBRECIPIENT CASH MANAGEMENT NEEDS IMPROVEMENT

The Department of Environment and Natural Resources did not have adequate monitoring procedures in place to ensure that subrecipients in the Clean Water and Drinking Water State Revolving Funds programs expended funds in accordance with the cash management requirements communicated in the Offer and Acceptance Document. As a result, there was an increased risk of excess cash being held by the subrecipients and lost interest earnings at the state level.

The Offer and Acceptance (Binding Commitment) document, Section 2 - Assurances, requires the subrecipient to expend all of the requisitioned loan/grant proceeds for the purpose of paying costs of projects within three banking days of receipt of such funds from the State. However, the Department did not perform monitoring procedures to verify that the subrecipients expended funds within the required three banking days. During the audit period, 45 subrecipients received \$40,935,368 in Capitalization Grants for Clean Water State Revolving Funds and 75 subrecipients received \$53,083,533 in Drinking Water State Revolving Funds.

According to the OMB Circular A-133 Compliance Supplement, subrecipients should be monitored to provide reasonable assurance that the subrecipient administers federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved.

Significant aspects of this finding were also reported in a prior year finding.

*Federal Award Information:* This Finding affects CFDA 66.458 Capitalization Grants for Clean Water State Revolving Fund and Federal awards CS-37000107 for the award period July 1, 2007 - December 31, 2012; CS-37000108 for the award period October 1, 2008 - September 30, 2012; CS-37000109 for the award period of April 1, 2009 - March 31, 2012 and 2W-95421209 for the award period of March 16, 2009 - October 30, 2012.

The finding also affects CFDA 66.468 Capitalization Grants for Drinking Water State Revolving Funds and Federal awards FS-98433804 for the award period of July 1, 2005 - September 30, 2010; FS-98433805 for the award period July 1, 2006 - September 30, 2011; FS-98433806 for the award period of July 1, 2007 - September 30, 2012; FS-98433807 for the award period of July 1, 2008 - September 30, 2013; FS-98433808 for the award period of July 1, 2009 - September 14, 2014 and 2F-95423309 for the award period April 1, 2009 - March 31, 2012.

*Recommendation:* The Department should strengthen its subrecipient monitoring by including procedures to verify that cash management requirements are met.

*Agency Response:* The Department agrees with the finding. Corrective action has been implemented. As of September, 2011, the single audit compliance supplement now contains a requirement that the single audit include a verification that the cash management requirements in the contract between the Department and the Subrecipient are met.

## **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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