



# STATE OF NORTH CAROLINA

**DEPARTMENT OF ENVIRONMENT AND NATURAL RESOURCES**

**STATEWIDE FEDERAL COMPLIANCE AUDIT PROCEDURES**

**FOR THE YEAR ENDED JUNE 30, 2012**

**OFFICE OF THE STATE AUDITOR**

**BETH A. WOOD, CPA**

**STATE AUDITOR**

**DEPARTMENT OF ENVIRONMENT AND NATURAL RESOURCES**

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State Auditor

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

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**AUDITOR'S TRANSMITTAL**

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The Honorable Pat McCrory, Governor  
Members of the North Carolina General Assembly  
John E. Skvarla, III, Secretary  
Department of Environment and Natural Resources

As part of our audit of the State of North Carolina's compliance with requirements applicable to its major federal programs, we have completed certain audit procedures at the Department of Environment and Natural Resources for the year ended June 30, 2012. Our audit was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes*. We conducted the audit 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*.

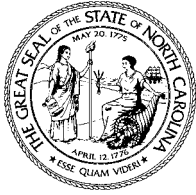
Our audit objective was to render an opinion on the State of North Carolina's, and not the Department's, administration of major federal programs. However, the report included herein is in relation to our audit scope at the Department and not to the State of North Carolina as a whole. The State Auditor expresses an opinion on the State's compliance with requirements applicable to its major federal programs in the State's *Single Audit Report*.

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



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**INDEPENDENT AUDITOR'S 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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John E. Skvarla, 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, 2012, 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 Revolving Funds
- CFDA 66.468 Capitalization Grants for Drinking Water 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.

**INDEPENDENT AUDITOR'S 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

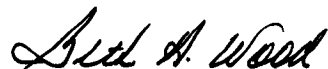
Management is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered internal control over compliance with the requirements 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. However, we consider the deficiencies described in findings 1 and 2 in the Audit Findings and Responses section of this report to be material weaknesses 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 of the Department of Environment and Natural Resources, 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 5, 2013

## **AUDIT FINDINGS AND RESPONSES**

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

#### **1. INADEQUATE REVIEW PROCEDURES FOR SUBRECIPIENT AUDIT REPORTS**

The Department of Environment and Natural Resources does not have adequate procedures in place for the review of subrecipient audit reports. As a result, errors and omissions in the subrecipients' Schedule of Expenditures of Federal and State Awards (SEFSA) were undetected, resulting in the possibility that required audit procedures were not performed.

We tested thirty-three audit reports for subrecipients that received \$500,000 or more in federal Clean Water CWSRF) and Drinking Water (DWSRF) State Revolving Funds from the Department and noted the following errors.

Three audit reports did not identify the CWSRF federal expenditures in the SEFSA. These subrecipients received a total of \$5,205,775 during the report period.

Three audit reports did not identify the DWSRF federal expenditures in the SEFSA. These subrecipients received a total of \$7,642,933 during the report period.

One audit report omitted the SEFSA, but the entity received \$3,470,145 in CWSRF federal funds during the report period.

OMB Circular A-133 requires non-federal entities that expend \$500,000 or more in federal awards to have a single audit conducted for that year. When federal expenditures are not accurately identified in the subrecipient Schedule of Expenditures of Federal and State Awards it is likely that programs will not be subjected to all applicable audit requirements.

*Federal Award Information:* This finding affects CFDA 66.458 Capitalization Grants for the 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 review of subrecipient audit reports to ensure that the SEFSA is reviewed for proper inclusion and identification of grant funds provided by the Department as well as accuracy of the grant amounts.

*Agency Response:* Department agrees with the Finding. Since these are local government audit reports that are reviewed and approved by the Local Government Commission in the Department of the State Treasurer prior to being approved for release, we are working with that agency to ensure that local governments properly classify CWSRF and DWSRF funds. Corrective action will be implemented before the next local government audit cycle.

## AUDIT FINDINGS AND RESPONSES (CONCLUDED)

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

The Department of Environment and Natural Resources does 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 is an increased risk that subrecipients are not conforming to the same standards of timing as the pass-through entity which may result in excess cash being held by subrecipients and lost interest earnings to the State.

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 the project within three banking days of receipt of such funds from the State. During the audit period 20 subrecipients received \$27,396,667 in Capitalization Grants for Clean Water State Revolving Funds and 47 subrecipients received \$16,416,203.77 Drinking Water State Revolving Funds.

OMB Circular A-133 requires that subrecipients 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 has been reported for three consecutive years.

*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 07/01/2007 – December 31, 2012; CS-37000109 for the award period of April 1, 2009 – March 31, 2012; CS-37000110 for the award period of October 1, 2010 – September 30, 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-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; FS-9843309 for the award period of July 1, 2009 – September 30, 2014; FS-98433810 for the award period of July 1, 2010 – September 30, 2015; 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. In addition, the DENR Internal Audit Staff will monitor subrecipients for compliance.

## 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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