

STATE OF NORTH CAROLINA

OFFICE OF THE STATE AUDITOR
BETH A. WOOD, CPA



DEPARTMENT OF ENVIRONMENT AND NATURAL RESOURCES

RALEIGH, NORTH CAROLINA
STATEWIDE FEDERAL COMPLIANCE AUDIT PROCEDURES
FOR THE YEAR ENDED JUNE 30, 2014



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STATE OF NORTH CAROLINA
Office of the State Auditor



Beth A. Wood, CPA
State Auditor

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AUDITOR'S TRANSMITTAL

The Honorable Pat McCrory, Governor
Members of the North Carolina General Assembly
Donald R. van der Vaart, 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, 2014. 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 was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes*.

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 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 OMB Circular A-133, this 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
State Auditor**

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Article V, Chapter 147 of the North Carolina General Statutes, gives the Auditor broad powers to examine all books, records, files, papers, documents, and financial affairs of every state agency and any organization that receives public funding. The Auditor also has the power to summon people to produce records and to answer questions under oath.



INDEPENDENT AUDITOR'S REPORT

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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**

Donald R. van der Vaart, Secretary and
Management of the Department of Environment and Natural Resources

Report on Compliance for Each Major Federal Program

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, 2014, 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.

Management's Responsibility

Management is responsible for compliance with laws, regulations, contracts, and grants applicable to federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the State of North Carolina's major federal programs based on our audit of the types of compliance requirements referred to above, which we issue in the State's *Single Audit Report*. 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. However, our audit does not provide a legal determination of the Department's compliance with those requirements.

Opinion on Each Major Federal Program

As stated above, our opinion on compliance for each of the State of North Carolina's major federal programs is included in the State's *Single Audit Report*.

Other Matters

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.

Report on Internal Control Over Compliance

Management of Department of Environment and Natural Resources is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered internal control over compliance with the types of requirements that could have a direct and material effect on a major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program 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 material weaknesses or significant deficiencies, and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. However, we identified a deficiency in internal control over compliance, as described in the finding in the Finding, Recommendation, and Response section of this report that we consider to be a significant deficiency.

Department of Environment and Natural Resources's Response to the Audit Finding

The Department's response to the finding identified in our audit is included in the Finding, Recommendation, and Response section of this report. The Department's response was not subjected to the auditing procedures applied in the audit of compliance or consideration of internal control over compliance, and accordingly, we express no opinion on it.

Purpose of Report on Internal Control Over Compliance

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this communication is not suitable for any other purpose.



Beth A. Wood, CPA
State Auditor

Raleigh, North Carolina

March 24, 2015



FINDING, RECOMMENDATION, AND RESPONSE

MATTER RELATED TO FEDERAL COMPLIANCE OBJECTIVES

CONSTRUCTION PROJECT INSPECTIONS WERE NOT MONITORED BY MANAGEMENT TO ENSURE TIMELY PERFORMANCE AND PUBLIC HEALTH IS PROTECTED

The Department of Environment and Natural Resources does not have a system in place that monitored the inspection process to ensure that inspections are performed timely for drinking water construction projects. If projects are not inspected at each critical stage of construction, it may result in final projects that do not comply with design standards required to protect public drinking water from harmful contaminants. During fiscal year 2014, the Department paid \$23.3 million in federal funds for 50 drinking water construction projects and performed on-site inspections for 28 construction projects that received \$13.9 million in federal funds.

Management relies on the project engineers to perform on-site inspections as the engineers feel inspections are necessary. As such, management does not:

- 1) maintain a defined site inspection plan for the year to ensure necessary visits are scheduled,
- 2) monitor to ensure site inspections are performed at the appropriate stages in the construction project, and
- 3) have a supervisory review of site inspection documentation for quality.

The Department has a project closeout checklist that requires a final inspection prior to making final payment on the project.

Currently the Department only has a Departmental memo that requires construction projects to be inspected at least near project completion to ensure the construction matches the approved plans. Also, the memo states that optional inspections may be conducted as considered necessary throughout the project, but does not define criteria or documentation for making the determination of other necessary inspections.

OMB Circular A-133 requires the state to monitor the activities of subrecipients as necessary to ensure that Federal awards are used in compliance with provisions of contracts and that performance goals are achieved.

Federal Award Information

This finding affects 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 13, 2014; FS-98433809 for the award period of July 1, 2010 – September 13, 2015; FS-98433810 for the award period of July 1, 2011 – September 30, 2016; FS-98433811 for the award period July 1, 2012 – September 30, 2017; FS-98433812 for the award period of July 1, 2013 – September 30, 2018; and FS-98433813 for the award period of July 1, 2013 – September 30, 2018.

Recommendations

The Department should implement a detailed monitoring plan and tracking system to ensure that drinking water on-site inspections are being performed as required and necessary.

Management should implement procedures to ensure site inspections are being completed in accordance with a prescribed plan and perform supervisory review of site inspection documentation.

Agency Response

The Department agrees with the finding. The Department started developing a new construction management standard operating procedure to cover both the Drinking Water State Revolving Fund (DWSRF) program and the Clean Water State Revolving Fund (CWSRF) program in early February 2015. The new procedure will be largely based upon the practices currently used in the management of the CWSRF program (not cited for any findings), but will incorporate some aspects of the DWSRF program. The new procedure will include a mechanism to establish unique inspection plans based on project specific criteria. Supervisory and staff responsibilities will be clearly defined to ensure inspection plans are implemented appropriately.

The Department is currently developing a new project database to cover all programs in the Division of Water Infrastructure. The new database will provide tracking of all major project milestones including construction inspections. Due to the scope of this project, there is no firm timeline for the completion of the database at this time. Therefore, in the interim, current databases will be modified to provide additional inspection tracking and reporting to management.

The Department expects the draft standard operating procedure to be developed by the end of March and finalized in order to begin staff training by the end of April 2015.

ORDERING INFORMATION

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This audit was conducted in 1,611 hours at an approximate cost of \$151,434.