

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, 2015



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STATE OF NORTH CAROLINA
Office of the State Auditor



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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, 2015. We conducted our audit in accordance with the auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Governmental 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 in this 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*, 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

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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

STATE OF NORTH CAROLINA
Office of the 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**

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

Report on 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, 2015, 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 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 Findings, Recommendations, and Responses section of this report that we consider to be a significant deficiency.

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

The Department's response to the finding identified in our audit is included in the Findings, Recommendations, and Responses 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 28, 2016



FINDINGS, RECOMMENDATIONS, AND RESPONSES

Matters Related to Federal Compliance Audit Objectives

The following audit finding was identified during the current audit and describes a condition that represents a deficiency in internal control.

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

The Department of Environment Quality did not monitor the inspection process to ensure that inspections were performed for drinking water and clean water construction projects (totaling \$78.8 million in federal funds). Although all necessary inspections were performed during the audit period, the Department did not have a process in place which would notify management if an inspection had not occurred.

If projects are not inspected, it may result in final projects that do not comply with design standards required to protect public drinking water and surface (clean) waters from harmful contaminants and pollutants.

Monitoring was not performed because, during the year, management relied on the project engineers to perform on-site inspections when the engineers felt inspections were necessary. There was no monitoring plan for inspections.

Effective May 2015, the Department issued new standard operating procedures (SOP) for construction management that established inspection plans based on project specific criteria. The plan is signed by the supervisor and included in the project file. However, the new SOP did not ensure that the supervisor monitored to ensure inspections were executed according to the project plans. Additionally, the SOP did not ensure that the supervisor reviewed site inspection documents to ensure quality inspections were performed.

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.

Significant aspects of this finding were reported in the prior year.

Federal Award Information

This finding affects federal awards for CFDA 66.458 Capitalization Grant for Clean Water State Revolving Funds. Awards, as follows: CS-37000111 for the award period of October 1, 2011 – September 30, 2014; CS-37000112 for the award period of August 1, 2012 – December 31, 2014; and CS-37000114 for the award period of July 1, 2014 – September 30, 2016.

This finding affects federal awards for CFDA 66.468 Capitalization Grant for Drinking Water State Revolving Funds. Awards, as follows: 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; FS-98433813 for the award period of July 1, 2013 – September 30, 2018 and FS-98433814 for the award period of October 1, 2014 – September 30, 2019.

Recommendation

Management should revise its standard operating procedures to include monitoring procedures that ensure site inspections are completed in accordance with the prescribed plan and perform supervisory review of site inspection documentation.

Agency Response

The Department agrees with the finding. As of January 2016, management is tracking all inspections and inspection plan deadlines in a combination of existing databases and spreadsheets. Supervisors receive copies of all completed inspection checklist and reports to document inspection completion. The construction management SOP will be updated to reflect these management oversight activities.

The Department expects to have all of the corrective action in place by February 29, 2016.

ORDERING INFORMATION

COPIES OF THIS REPORT MAY BE OBTAINED BY CONTACTING:

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For additional information contact:
Bill Holmes
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919-807-7513



This audit was conducted in 1,722 hours at an approximate cost of \$170,478.