

STATE OF NORTH CAROLINA

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA



DEPARTMENT OF ENVIRONMENTAL QUALITY

RALEIGH, NORTH CAROLINA

STATEWIDE FEDERAL COMPLIANCE AUDIT PROCEDURES

FOR THE YEAR ENDED JUNE 30, 2016



NC OSA
The Taxpayers' Watchdog

STATE OF NORTH CAROLINA
Office of the State Auditor



Beth A. Wood, CPA
State Auditor

2 S. Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0600
Telephone: (919) 807-7500
Fax: (919) 807-7647
<http://www.ncauditor.net>

AUDITOR'S TRANSMITTAL

The Honorable Roy Cooper, Governor
Members of the North Carolina General Assembly
Michael S. Regan, Secretary
Department of Environmental Quality

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 Environmental Quality for the year ended June 30, 2016. We conducted our audit in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Governmental Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). 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 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 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 in this 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*, 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 black ink that reads "Beth A. Wood".

Beth A. Wood, CPA
State Auditor



Beth A. Wood, CPA
State Auditor

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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 THE UNIFORM GUIDANCE**

Michael S. Regan, Secretary
and Management of the Department of Environmental Quality

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 Compliance Supplement* that could have a direct and material effect on each of its major programs for the year ended June 30, 2016, we have performed audit procedures at the Department of Environmental Quality. 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 Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance) is included in the State's *Single Audit Report*. Our federal compliance audit scope at the Department of Environmental Quality included the following:

- CFDA 93.568 - Low-Income Home Energy Assistance

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 federal statutes, regulation, and the terms and conditions of its federal awards applicable to its 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 the audit requirements of Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*

(Uniform Guidance). Those standards and the Uniform Guidance 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 Environmental Quality disclosed instances of noncompliance that are required to be reported in accordance with the Uniform Guidance and which are described in findings 1 and 2 in the Findings, Recommendations, and Responses section of this report.

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 the Uniform Guidance, 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 certain deficiencies in internal control over compliance, as described in findings 1 and 2 in the Findings, Recommendations, and Responses section of this report, that we consider to be significant deficiencies.

Department of Environmental Quality's Response to Findings

The Department's responses to the findings identified in our audit are included in the Findings, Recommendations, and Responses section of this report. The Department's responses were not subjected to the auditing procedures applied in the audit of compliance, and accordingly, we express no opinion on the response.

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 the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.



Beth A. Wood, CPA
State Auditor
Raleigh, North Carolina

March 16, 2017



FINDINGS, RECOMMENDATIONS, AND RESPONSES

Matters Related to Federal Compliance Objectives

The following audit findings were identified during the current audit and describe conditions that represent deficiencies in internal control or noncompliance with laws, regulations, contracts, grant agreements, or other matters.

1. RESULTS FROM SITE VISITS NOT COMMUNICATED TIMELY

The Department of Environmental Quality (Department) did not report the results of programmatic¹ and fiscal² monitoring visits to subrecipients timely or obtain subrecipient corrective action plans. The Department distributed approximately \$20 million in low-income home energy assistance to 21 subrecipients during the fiscal year ended June 30, 2016.

Auditors reviewed all programmatic and fiscal monitoring reviews for each subrecipient, some with multiple visits, and found the following.

Programmatic monitoring reviews:

- For 22 of the 25 (88%) reviews, results were communicated between 31 and 139 days after the review. Deficiencies were reported in 21 of the 25 reviews.
- For 8 of the 21 (38%) reviews with deficiencies, corrective action plans were not obtained from the subrecipient.

Fiscal monitoring reviews:

- For 7 of the 20 (35%) reviews, results were communicated between 35 and 113 days after the review. Deficiencies were reported in 11 of the 20 reviews.
- For 4 of the 11 (36%) reviews that found deficiencies, corrective action plans were not obtained from the subrecipient.

As a result, corrective action was delayed, which increased the risk that program goals of home energy cost-reduction and proper use of federal funds would not be met. Findings noted in the final assessment letters included, but were not limited to:

- Installation standards³ for weatherizing homes not being met. Some of the issues noted included failure to properly air seal homes, failure to properly vent clothes dryer outdoors, and failure to properly evaluate refrigerators for potential energy savings.
- Unallowable costs charged to the program, such as advertising and public relations costs.
- State purchasing policies not being followed, such as preparing purchase orders after goods and services were ordered.

¹ Programmatic Monitoring includes an on-site review and inspection of the subrecipient's client records to determine client eligibility (income, age, need, etc.) and quality of work performed on completed units to determine compliance with federal requirements.

² Fiscal Monitoring includes an on-site review or desk review of the subrecipient's financial records (general ledger, expenditures, cost allocation, etc.) to determine compliance with federal requirements.

³ North Carolina Weatherization Installation Standards

According to the Department, it was understaffed during the audit year. The Department lost a Programmatic Monitor in August 2015 and a Fiscal Monitor in October 2015. Management chose to focus on completing the monitoring site visits and did not place priority on sending final assessment letters or obtaining corrective action plans.

Federal regulations⁴ require that monitoring include “following-up and ensuring that the subrecipient takes timely and appropriate action on all deficiencies...detected through audits, on-site reviews, and other means.” Also, Department procedures require monitors to submit a final assessment letter within 30 days following the monitoring visit or desk review. Subrecipients are required to provide a corrective action plan for each finding no later than 30 days from the date of the correspondence.

Federal Award Information: Federal Awarding Agency: U.S. Department of Health and Human Services; CFDA Number (title): 93.568 (Low-Income Home Energy Assistance); Federal Award Number (award period): 15B1NCLIEA (October 1, 2014 – September 30, 2016); 16B1NCLIEA (October 1, 2015 – September 30, 2017).

Recommendation: The Department should develop a monitoring plan that ensures adequate resources are provided and appropriate priority placed on monitoring visits, communicating results, and obtaining corrective action plans. The plan should consider contingencies, such as loss of staff, which would hinder the Departments monitoring efforts.

Agency Response: The Department agrees with the finding. The finding noted an issue with the timeliness of the final assessment letters not being sent in accordance with Department’s monitoring plan. The Department will modify the current monitoring plan and monitoring database and will include mechanisms to ensure that assessment letters are delivered in a timely manner.

The revised plan will include designating a primary and secondary person to monitor the status of compliance monitoring and the related assessment letters. The revised plan will also state that whenever monitoring staffing levels fall below two monitors each for either fiscal or programmatic monitoring, temporary monitoring staff will be secured to ensure that monitoring of subgrantees and the delivery of assessment letters to them occurs in a timely manner and that Corrective Action Plans from the subgrantees are received in a timely manner. Modifications to the monitoring plan will be completed by February 28, 2017.

⁴ 2 CFR 200.331(d)(2)

2. DEFICIENCY IN SYSTEM ACCESS AND CHANGE CONTROLS

The results of our audit disclosed a security deficiency considered reportable under generally accepted *Government Auditing Standards*. This deficiency is reported to the Department by separate letter in accordance with these standards. This item should be kept confidential as provided by *North Carolina General Statute 132-6.1(c)*.

Federal Award Information: Federal Awarding Agency: U.S. Department of Health and Human Services; CFDA Number (title): 93.568 (Low-Income Home Energy Assistance); Federal Award Number (award period): 15B1NCLIEA (October 1, 2014 – September 30, 2016); 16B1NCLIEA (October 1, 2015 – September 30, 2017).

Agency Response: The Department agrees with the finding. The Department is committed to maintaining information security and system access controls. The Department is working on corrective actions to address the risks identified by the audit team, which have been detailed in a response separately submitted to OSA. All system access and change controls will comply with the applicable portions of the North Carolina Statewide Information Security Manual.

ORDERING INFORMATION

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For additional information contact:
Bill Holmes
Director of External Affairs
919-807-7513

