



# STATE OF NORTH CAROLINA

**DEPARTMENT OF ENVIRONMENT AND NATURAL RESOURCES**

**FISCAL CONTROL AUDIT OF  
DURING-THE-AWARD MONITORING  
OF SUBRECIPIENTS RECEIVING  
AMERICAN RECOVERY AND REINVESTMENT ACT FUNDS**

**OFFICE OF THE STATE AUDITOR**

**BETH A. WOOD, CPA**

**STATE AUDITOR**

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## AUDITOR'S TRANSMITTAL

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July 28, 2010

The Honorable Beverly Eaves Perdue, Governor  
Members of the North Carolina General Assembly  
Mr. Dee A. Freeman, Secretary  
Department of Environment and Natural Resources

This report presents the results of our fiscal control audit at the Department of Environment and Natural Resources. Our work was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes* and was conducted in accordance with the performance audit standards contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. The objective of a fiscal control audit is to identify improvements needed in internal control over selected fiscal matters, such as financial accounting and reporting; compliance with finance-related laws, regulations, and provisions of contracts or grant agreements; and/or management of financial resources. The specific objective of this fiscal control audit was to identify improvements needed in the during-the-award monitoring of American Recovery and Reinvestment Act grants to subrecipients.

The results of our audit disclosed deficiencies in internal control and/or instances of noncompliance or other matters that are considered reportable under *Government Auditing Standards*. These items are described in the Audit Findings and Responses section of this 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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# **OBJECTIVES, SCOPE, METHODOLOGY, AND RESULTS**

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## **OBJECTIVES, SCOPE, AND METHODOLOGY**

As authorized by Article 5A of Chapter 147 of the *North Carolina General Statutes*, we have conducted a fiscal control audit at the Department of Environment and Natural Resources. We conducted this audit because of the increased interest in the use of American Recovery and Reinvestment Act funds and potential risks associated with those expenditures, particularly when grant funds are expended by subrecipients.

The objective of a fiscal control audit is to identify improvements needed in internal control over selected fiscal matters, such as financial accounting and reporting; compliance with finance-related laws, regulations, and provisions of contracts or grant agreements; and/or management of financial resources. The specific objective of this fiscal control audit was to identify improvements needed in the during-the-award monitoring of American Recovery and Reinvestment Act grants to subrecipients. Our audit does not provide a basis for rendering an opinion on internal control, and consequently, we have not issued such an opinion.

Management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that relevant objectives are achieved. Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

To accomplish our audit objective, we gained an understanding of internal control over during-the-award monitoring of subrecipients' administration of American Recovery and Reinvestment Act funds and evaluated the design of the internal control. We then performed direct tests of compliance for selected subrecipients receiving the funds and compared our results to those achieved through the Department of Environment and Natural Resources' during-the-award monitoring procedures. Whenever sampling was used, we applied a nonstatistical approach. As a result, we cannot quantify the sampling risk associated with any projection of our results to the population.

As a basis for evaluating internal control, we applied the internal control guidance contained in *Internal Control Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). As discussed in the framework, internal control consists of five interrelated components, which are (1) control environment, (2) risk assessment, (3) control activities, (4) information and communication, and (5) monitoring.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions

## **OBJECTIVES, SCOPE, METHODOLOGY, AND RESULTS (CONCLUDED)**

based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Our audit scope covered the period July 1, 2009 through February 28, 2010 and included the Capitalization Grant for the Clean Water State Revolving Fund that has received American Recovery and Reinvestment Act funds. The Department disbursed American Recovery and Reinvestment Act funds of approximately \$14 million to subrecipients during the audit period.

We performed our tests of compliance on the following subrecipients of the funds:

- Pitt County
- City of Conover
- Town of Kure Beach

### **RESULTS**

The results of our audit disclosed instances where subrecipients have not administered American Recovery and Reinvestment Act funds in accordance with federal requirements. Further, we identified certain improvements needed in the Department of Environment and Natural Resources' during-the-award monitoring procedures. These items are described in the Audit Findings and Responses section of this report.

## AUDIT FINDINGS AND RESPONSES

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### SUBRECIPIENT MONITORING NEEDS IMPROVEMENT

The Department of Environment and Natural Resources did not consistently perform effective monitoring procedures to ensure that subrecipients of the American Recovery and Reinvestment Act (ARRA) funds were in compliance with requirements of the Davis-Bacon Act. As a result, noncompliance with federal compliance requirements at the subrecipient level was not detected by the Department.

Title 29 CFR part 5 requires contractors and subcontractors to submit weekly, for each week in which contract work is performed, a copy of the payroll, and a statement of compliance to the subrecipient. The CFR also requires interviews with employees and examination of payroll data for compliance with labor standards. The Department of Environment and Natural Resources provided guidance to subrecipients that states the recipient or consulting engineer should interview the lesser of one employee from each contract or 20% of all employees on a project.

For the three subrecipients included in our test, we noted the following noncompliance with the Davis-Bacon Act:

- One subrecipient did not conduct interviews with employees from each contract and subcontract associated with the project.
- Two subrecipients did not obtain certified payrolls from all of its subcontractors.
- For two subrecipients, we found documentation of an interview with a subcontractor's employee, but the documentation did not contain evidence that the employee's job classification or hourly rate had been verified for compliance with labor standards. We were unable to verify compliance because the certified payrolls were not available.

This issue impacts the Capitalization Grant for the Clean Water State Revolving Fund (CFDA 66.458) compliance for ARRA grant 2W-95421209.

*Recommendation:* The Department should enhance its monitoring procedures to ensure that subrecipients receiving ARRA funds are in compliance with the requirements of the Davis-Bacon Act.

*Agency Response:* The Division of Water Quality, Construction Grants and Loans Section, has increased the monitoring efforts related to Davis-Bacon Act compliance of its staff, and provided additional monitoring instruction and requirement to local governments and contractors. The following actions have been taken:

- Modified State Revolving Loan (SRF) contract special conditions that are incorporated into the construction contracts.

## **AUDIT FINDINGS AND RESPONSES (CONCLUDED)**

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- Briefed SRF construction inspectors on the ARRA compliance issues and established appropriate inspection procedures to achieve full compliance.
- Incorporated pertinent EPA SRF State Inspection Checklist information into the ARRA portions of monthly inspection reports.
- Informed ARRA subrecipients of the need to comply with Davis-Bacon Act requirements.
- Followed up with the local government subrecipients to take corrective action on the specific noncompliance instances identified in the audit. This effort is still in process.



## **ORDERING INFORMATION**

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