

STATE OF NORTH CAROLINA

AUDIT RESULTS FROM

CAFR AND SINGLE AUDIT PROCEDURES

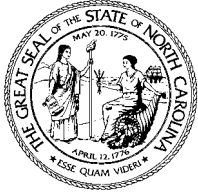
**DEPARTMENT OF ENVIRONMENT AND NATURAL
RESOURCES**

FOR THE YEAR ENDED JUNE 30, 2001

OFFICE OF THE STATE AUDITOR

RALPH CAMPBELL, JR.

STATE AUDITOR



Ralph Campbell, Jr.
State Auditor

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April 10, 2002

The Honorable Michael F. Easley, Governor
Members of the North Carolina General Assembly
Mr. William G. Ross, Jr., Secretary
Department of Environment and Natural Resources

We have completed certain audit procedures at the Department of Environment and Natural Resources related to the State's *Comprehensive Annual Financial Report (CAFR)* and the State's *Single Audit Report*, for the year ended June 30, 2001. Our audit was made by authority of Article 5A of *North Carolina General Statute § 147*.

The results of these procedures, as described below, yielded audit findings and recommendations for the Department related to the State's federal financial assistance programs which required disclosure in the aforementioned reports. The findings noted above are included in the findings and recommendations section contained herein. Our recommendations for improvement and management's response follow each finding.

We noted internal control weaknesses and instances of noncompliance with Federal regulations at the North Carolina Department of Environment and Natural Resources. These deficiencies pertained to the environmental review process and monitoring efforts, and reporting associated with the Drinking Water State Revolving Fund.

The accounts and operations of the Department of Environment and Natural Resources are an integral part of the State's reporting entity represented in the *CAFR* and the *Single Audit Report*. In the *CAFR*, the State Auditor expresses an opinion on the State's financial statements. In the *Single Audit Report*, the State Auditor also presents the results of tests on the State's internal control and on the State's compliance with laws, regulations, contracts, and grants applicable to the State's financial statements and to its federal financial assistance programs. The audit procedures were conducted in accordance with auditing standards generally accepted in the United States of America, *Government Auditing Standards* issued by the Comptroller General of the United States, and Office of Management and Budget Circular A-133.

As part of the work necessary for issuance of the *CAFR* and the *Single Audit Report*, the following individual funds and federal programs of the State were subjected to audit procedures at the Department of Environment and Natural Resources as we considered necessary:

Funds for the *Comprehensive Annual Financial Report*:

- GASB 1380 Special Revenue Fund
- GASB 1400 Capital Improvements Fund
- GASB 1423 Capital Improvements Fund
- GASB 3220 Non Expendable Trust Fund
- GASB 5100 General Fixed Assets Account Group

Federal Programs for the *Single Audit Report*

- 64.458 Drinking Water State Revolving Fund
- 64.468 Clean Water State Revolving Fund

The individual funds and federal programs subjected to audit at the Department of Environment and Natural Resources are substantially less in scope than would be necessary to report on the general-purpose financial statements that relate solely to the Department or the administration of federal programs by the Department. Therefore, we do not express such conclusions.

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.

Respectfully submitted,



Ralph Campbell, Jr.
State Auditor

AUDIT FINDINGS AND RECOMMENDATIONS

Current Year Findings and Recommendations - The following findings and recommendations were identified during the current audit and represent significant deficiencies in internal control or noncompliance with laws, regulations, contracts, or grants.

1. NONCOMPLIANCE WITH ENVIRONMENTAL REVIEW REQUIREMENTS

Environmental reviews were not conducted on the seven Drinking Water State Revolving Fund projects that began during the state fiscal year ended June 30, 2001. Not following the procedures could result in negative environmental impact on projects. Disbursements made to these seven projects totaled \$7,686,800.

In accordance with 40 CFR 35.3580, the Department elected to develop its own National Environmental Policy Act (NEPA-like) State Environmental Review Process (SERP) which was approved by the EPA Regional Administrator on October 19, 1999.

Recommendation: The Department should conduct environmental reviews in accordance with the EPA approved NEPA-like SERP.

Agency's Response: Projects with binding commitments before January 6, 2001 received environmental review and documentation consistent with the State Environmental Policy Act. However, these projects lacked documentation of the full NEPA-like process established in the SERP. The Federal Environmental Protection Agency (EPA) pointed out this deficiency during their audit on January 6, 2001. As part of the remediation plan, the EPA approved these projects without further review.

A remediation plan was negotiated with EPA (in the form of Standard Operating Procedures) to bring procedures into full compliance with the SERP. Projects with offers extended after January 6, 2001 are accompanied by environmental review records meeting SERP requirements. All future projects will have environmental review records meeting SERP requirements.

We entered into binding agreements on a total of eight Drinking Water State Revolving Fund projects during the state fiscal year ending June 30, 2001. Of these, only one offer was extended after January 6, 2001. This project had a complete environmental review in accordance with the remediation plan with documentation meeting all SERP requirements including an April 10, 2001 notice of completion of environmental review from the Department of Administration and an April 12, 2001 approval by EPA Region IV. The Binding commitment date was May 15, 2001.

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

2. INADEQUATE SUBRECIPIENT MONITORING

Our review of the monitoring procedures over the Drinking Water State Revolving Fund disclosed the following:

- Site visits are not being documented consistently for projects prior to reaching the ninety percent construction completion stage. Only four of nineteen completed projects had documented site visits. Standardized procedures for documenting site visits do not exist.
- The Department does not adequately monitor the activities of the engineering firms that provide on site review of construction operations. Monitoring of the engineering firms is limited to reviews of reimbursement requests and its supporting documentation.

The 1998 Intended Use Plan (IUP) states that on-site inspections of the work in progress should be scheduled prior to reaching the ninety percent construction completion stage, and sooner if problems needing immediate resolution to maintain the project's integrity occur.

Recommendation: Standardized procedures for documenting site visits should be developed and the Department should monitor the engineering firms that are inspecting the ongoing operations of the projects.

Agency's Response: The inspections were performed, but the inspection documentation was not properly on file until after the State audit. Most inspections reports were in the field offices at the time of the State audit, but copies were later placed in the PWS Central Office files before the EPA audit in February 2002.

The SRF engineers have been instructed to perform the 90% inspections and in the cases where there is a problem because of workload or other issues, the SRF engineer is to coordinate assistance from our field staff to ensure these inspections are completed in a timely manner and proper documentation submitted to the PWS Central Office.

In the future, the SRF engineers will review project records and status periodically to determine inspections that are needed and perform these inspections or coordinate an inspection by field staff. The SRF engineer is to ensure that proper documentation is completed and in the files for review.

AUDIT FINDINGS AND RECOMMENDATIONS (CONCLUDED)

3. MATHEMATICAL INACCURACIES IN ANNUAL REPORT

The Drinking Water State Revolving Fund's annual report to the EPA was not mathematically accurate. Exhibit 2, "Source of Project Funds By Quarter" had discrepancies ranging from understatements of \$4,659,968 to \$5,323,374. Exhibit 7, "Loan Administrative Fee" had discrepancies ranging from understatements of \$90,240 to \$166,000. The total column in Exhibit 7 was understated by \$517,674.

The EPA Drinking Water State Revolving Fund Program Guidelines states that a State must provide a biennial report to the EPA containing detailed information on how the State met the goals and objectives of the previous two fiscal years as stated in its IUP and grant agreement. Good internal controls should require a thorough review of the annual report including its mathematical accuracy.

Recommendation: The Department should strengthen its internal controls by requiring a thorough review of the annual report by managerial personnel before the report is submitted to the EPA.

Agency's Response:

Exhibit 2 – The *detail* amounts reported for "Source of Project Funds by Quarter" are correct. The referenced discrepancies were in the First Quarter and Second Quarter *totals*, and were caused by errors in the spreadsheet formulas for the totals of those quarters. Grand Totals for the Fiscal Year 2000 were also accurately stated.

Exhibit 7 – The *detail* amounts reported for "Loan Administrative Fee" are correct. As with Exhibit 2, the discrepancies noted were caused by errors in the spreadsheet formulas for the Fiscal Year Totals. Cumulative Totals are accurately stated.

On January 15, 2002, notice was sent to EPA advising them of these discrepancies and providing them with corrected copies of both exhibits.

In the future, a more diligent and thorough review of mathematical accuracy will be performed in subsequent reporting.

DISTRIBUTION OF AUDIT RESULTS

In accordance with G.S. § 147-64.5 and G.S. § 147-64.6(c)(14), copies of this document have been distributed to the public officials listed below. Additional copies are provided to other legislators, state officials, the press, and the general public upon request.

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Mr. William G. Ross, Jr.	Secretary, Department of Environment and Natural Resources

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N. C. House Speaker Pro-Tem
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April 15, 2002

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