

**Office of the Secretary of State**

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February 27, 2008

Dick Pedersen, Interim Director  
Oregon Department of Environmental Quality  
811 SW 6th Avenue  
Portland, Oregon 97204

Dear Mr. Pedersen:

We have completed the statewide single audit that included a selected federal program at the Oregon Department of Environmental Quality (department) for the year ended June 30, 2007.

This audit work is not a comprehensive audit of your federal program. Instead, the audit work performed allowed us, in part, to achieve the following objectives: (1) determine whether the state has complied with laws, regulations, contracts or grants that could have a direct and material effect on the federal program; and (2) determine whether the state has effective internal controls over compliance with the laws, regulations, contracts and grants applicable to the federal program.

In planning and performing our audit, we considered the department's internal control over compliance with requirements that could have a direct and material effect on the federal program in order to determine our auditing procedures for the purpose of expressing our opinion on the department's compliance, 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 the department's internal control over compliance.

We audited the following federal program at the department to determine whether the department substantially complied with the federal requirements relevant to the federal program. Our audit does not provide a legal determination of the department's compliance with those requirements.

<u>CFDA Number</u>	<u>Program Name</u>	<u>Audit Amount</u>
66.458	Capitalization Grants for Clean Water State Revolving Funds	\$7,535,690

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control. As discussed below, we identified two significant deficiencies, one of which we consider to be a material weakness. In addition, we identified an other matter that warrant management's attention.

These deficiencies and the related instances of non-compliance are required to be reported in accordance with OMB Circular A-133.

A *control deficiency* in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the following deficiency to be a significant deficiency in internal control and an instance of non-compliance.

### Matching

Federal regulations require the department to provide state matching funds of at least 20 percent for federal grant payments that it receives. The matching funds must be deposited into the Clean Water State Revolving Fund by the date the department receives each grant payment. The department established a system to track the matching funds percentage on a quarterly basis instead of by individual grant payment. As a result, for part of fiscal year 2007, the department was not in compliance with the matching requirement. Specifically, in one instance, the department drew federal money, which dropped the matching funds below the 20 percent requirement. A deposit to raise the matching funds back to 20 percent was not made until approximately one month later.

**We recommend** department management design and implement effective controls to ensure matching funds of at least 20 percent are consistently provided by the date federal grant payments are received.

In the prior fiscal year, a significant deficiency was reported to you in a letter dated February 8, 2007, related to the department's lack of public notice documentation. This finding can also be found in the Statewide Single Audit Report for the fiscal year ended June 30, 2006; see audit report number 2007-06, finding number 06-23. During the current fiscal year, the department has made progress in correcting this finding. This finding will be reported in the Statewide Single Audit Report for the fiscal year ended June 30, 2007, with a status of partially corrected.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. We believe the following deficiency constitutes a material weakness and an instance of non-compliance:

### Environmental Review

Clean Water State Revolving Fund (CWSRF) design and construction projects are required to undergo environmental review before loan disbursements are made.

During fiscal year 2007, the department did not fully comply with the environmental review requirement. We reviewed eleven projects requiring environmental review, for which loans were executed during fiscal year 2007. Of these eleven projects, two did not show evidence of an environmental review. Additional requirements include notifying the public of the project. Ten of the eleven projects we reviewed did not show evidence that public notice had been given.

Additionally, we reviewed these projects for adherence to department procedures established to ensure the proper administration of CWSRF grant monies. These department procedures require that CWSRF loan applicants submit a completed Checklist of Exhibits and Requirements and associated documents, including planning and environmental review documents. These procedures also require department approval of the planning document prior to executing the loan agreement and department approval of the environmental review documentation prior to making loan disbursements. Of the eleven projects reviewed, we found the following:

- Seven projects did not have documentation of the department having received the required checklist.
- Four projects did not have planning documentation.
- Eight projects did not have evidence of department approval of planning documentation prior to execution of the loan agreement.
- Four projects did not have evidence of department approval of environmental review documentation prior to making the initial loan disbursement.

**We recommend** department management design and implement effective controls to ensure environmental reviews are completed and that public notice of projects is provided. We also recommend department management ensure department procedures established for proper administration of CWSRF monies are followed.

In addition to the significant deficiency and material weakness identified above, we identified an other matter that warrants management's attention.

### Subrecipient Monitoring Notification / Lack of Documentation

The department was assigned responsibility for completing the review of single audit reports in accordance with OMB Circular A-133 for ten subrecipients who received federal funds from the State of Oregon. The Oregon Accounting Manual (OAM) includes specific responsibilities and requirements for the review of subrecipient audit reports to ensure compliance with applicable OMB Circular A-133 requirements. These responsibilities include notifying subrecipients of the department's assignment as audit agency and the purpose of the assignment, and obtaining each subrecipient's audited financial statements and other pertinent documentation within the earlier of 30 days after receipt of the auditor's report or nine months after the end of the audit period.

The department also has the responsibility of reviewing the audit report within 90 days of either the receipt of the audit report or the department's notification of assignment as audit agency for the subrecipient.

We reviewed the department's monitoring for five subrecipient audit reports. We found that none of the five subrecipients had been notified that the department was the assigned audit agency or the purpose of the assignment. We also found that none of the five subrecipients' required reports and documents had a documented receipt date. Without a documented receipt date, the department cannot ensure they are receiving the required reports or reviewing them within the timelines required by the OAM.

**We recommend** department management notify subrecipients of the department's assignment as the audit agency and the purpose of the assignment under the provisions of OMB Circular A-133. We also recommend that department management ensure adequate documentation is maintained to determine if subrecipient information is received and reviewed within the timelines required by the OAM.

The significant deficiency and material weakness, along with your responses, will be included in our Statewide Single Audit Report for the fiscal year ended June 30, 2007. Including your responses satisfies the federal requirement that management prepare a Corrective Action Plan covering all reported audit findings. Satisfying the federal requirement in this manner, however, can be accomplished only if the responses to the significant deficiency and material weakness includes the information specified by the federal requirement, and only if the responses are received in time to be included in the audit report. The following information is required for each response:

1. Your agreement or disagreement with the finding. If you do not agree with an audit finding or believe corrective action is not required, include in your response an explanation and specific reasons for your position.
2. The corrective action planned.
3. The anticipated completion date.
4. The name(s) of the contact person(s) responsible for corrective action.

Please respond by March 7, 2008. The other matter does not require a written response. We will follow up on the department's progress in addressing this issue during the next fiscal year audit.

This communication is intended solely for the information and use of management, others within the organization, and the Environmental Quality Commission and is not intended to be and should not be used by anyone other than the specified parties.

Should you have any questions, please contact Diane Farris or me at (503) 986-2255.

Sincerely,

Dick Pedersen, Interim Director  
Oregon Department of Environmental Quality  
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OREGON AUDITS DIVISION

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Lynn Hampton, Chair, Environmental Quality Commission  
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