

**DEPARTMENT OF ENVIRONMENTAL QUALITY
RICHMOND, VIRGINIA**

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2000**



AUDIT SUMMARY

Our audit of the Department of Environmental Quality for the year ended June 30, 2000, found:

- proper recording and reporting of transactions, in all material respects, in the Commonwealth Accounting and Reporting System;
- no material weaknesses in internal control; and
- no instances of noncompliance with applicable laws and regulations tested that are required to be reported.

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March 15, 2001

The Honorable James S. Gilmore, III
Governor of Virginia
State Capitol
Richmond, Virginia

The Honorable Vincent F. Callahan, Jr.
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

INDEPENDENT AUDITOR'S REPORT

We have audited the financial records and operations of the **Department of Environmental Quality** for the year ended June 30, 2000. We conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

Audit Objectives, Scope, and Methodology

Our audit's primary objectives were to evaluate the accuracy of recording financial transactions on the Commonwealth Accounting and Reporting System, review the adequacy of the Department's internal control, and test compliance with applicable laws and regulations.

Our audit procedures included inquiries of appropriate personnel, inspection of documents and records, and observation of the Department's operations. We also tested transactions and performed such other auditing procedures as we considered necessary to achieve our objectives. We reviewed the overall internal accounting controls, including controls for administering compliance with applicable laws and regulations. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances:

Revenues	Payroll
Expenditures	Fixed Assets
Grant Management	Contract Management
Leases	Information Systems

We obtained an understanding of the relevant internal control components sufficient to plan the audit. We considered materiality and control risk in determining the nature and extent of our audit procedures. We performed audit tests to determine whether the Department's controls were adequate, had been placed in operation, and were being followed. Our audit also included tests of compliance with provisions of applicable laws and regulations.

The Department's management has responsibility for establishing and maintaining internal control and complying with applicable laws and regulations. Internal control is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

Our audit was more limited than would be necessary to provide assurance on internal control or to provide an opinion on overall compliance with laws and regulations. Because of inherent limitations in internal control, errors, irregularities, or noncompliance may nevertheless occur and not be detected. Also, projecting the evaluation of internal control to future periods is subject to the risk that the controls may become inadequate because of changes in conditions or that the effectiveness of the design and operation of controls may deteriorate.

Audit Conclusions

We found that the Department properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System. The Department records its financial transactions on the cash basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles. The financial information presented in this report came directly from the Commonwealth Accounting and Reporting System.

We noted no matters involving internal control and its operation that we considered to be material weaknesses. Our consideration of internal control would not necessarily disclose all matters in internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of the specific internal control components does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material to financial operations may occur and not be detected promptly by employees in the normal course of performing their duties.

The results of our tests of compliance with applicable laws and regulations disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

This report is intended for the information of the Governor and General Assembly, management, and the citizens of the Commonwealth of Virginia and is a public record.

Exit Conference

We discussed this report with Representatives of management at an exit conference held on April 12, 2001.

AUDITOR OF PUBLIC ACCOUNTS

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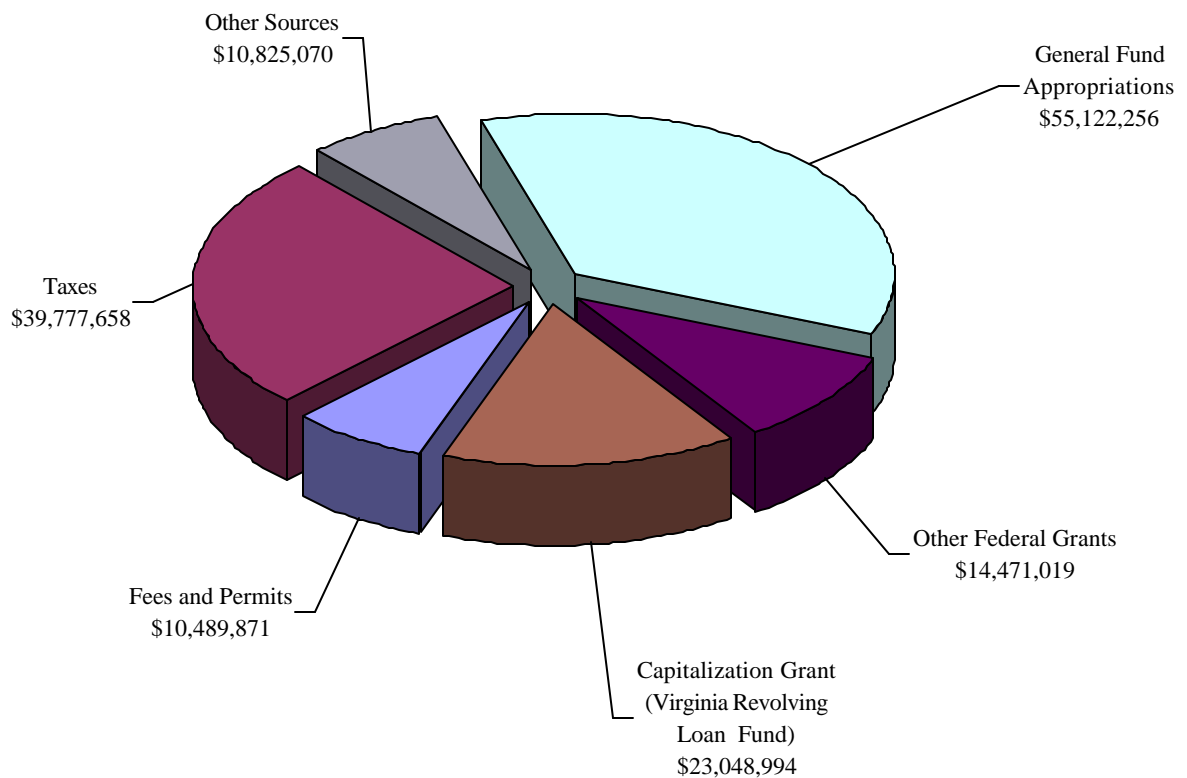
SELECTED AGENCY INFORMATION

General Overview

The Department of Environmental Quality (the Department) protects the Commonwealth's natural resources by administering state and federal environmental programs, issuing permits, monitoring water and air quality, and inspecting waste facilities. The Department conducts extensive monitoring to ensure compliance with state and federal standards for water quality, air quality, and waste management. The Department also enforces regulations promulgated by the State Water Control Board, the Board of Waste Management, and the Air Pollution Control Board.

The Department operates through its central office, seven regional offices, and four satellite and specialized offices. The following chart illustrates the Department's funding sources for fiscal year 2000.

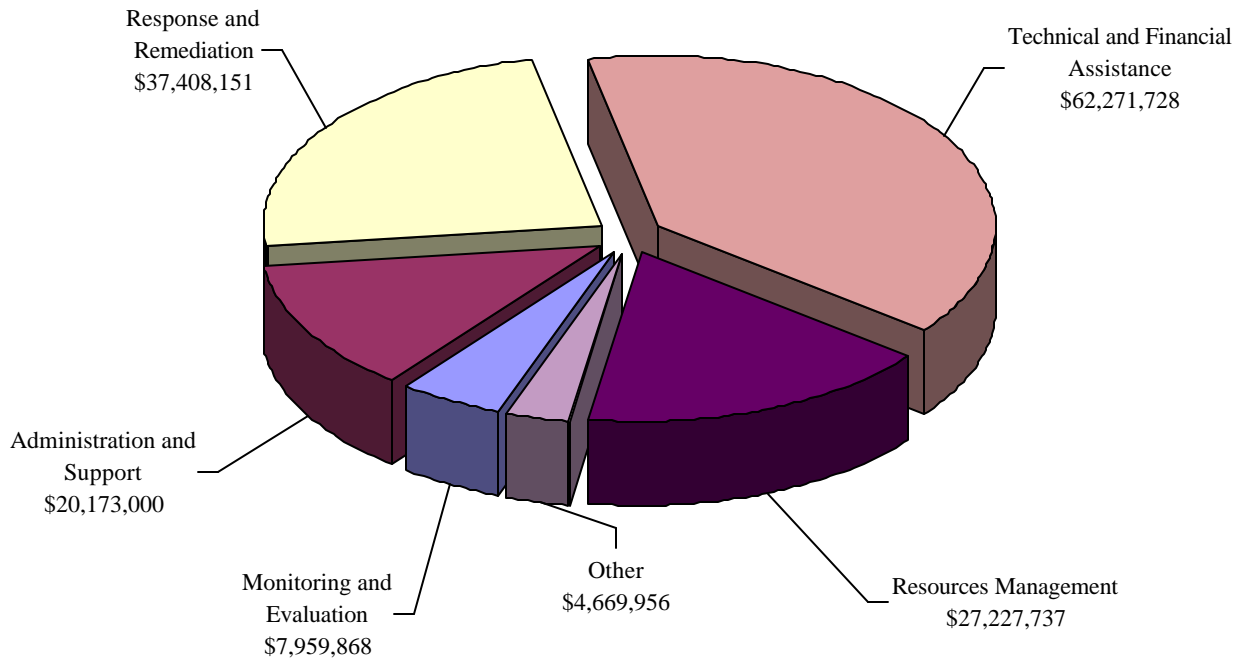
Funding Sources - Fiscal Year 2000



Taxes represent funds collected by other agencies and transferred to the Department for activities such as litter control, vehicle emissions inspection, or waste tire disposal. Other sources include recovery of indirect costs (\$3,984,412), civil penalties and charges (\$1,352,835), interest (\$4,938,554), and miscellaneous revenue (\$549,269).

The following chart shows the spending levels for the Department's various programs during fiscal year 2000:

Expenses - Fiscal Year 2000



Other programs include Research and Planning (\$2,564,747), Policy and Program Development (\$866,591), and Information and Education Assistance (\$1,238,618).

Virginia Water Quality Improvement Fund

The Water Quality Improvement Fund provides grants to local governments, soil and water conservation districts, and individuals for point and non-point-source pollution prevention, reduction, and control projects. The Department administers the point source pollution control portion of the program. The program's primary funding source consists of ten percent of the annual general fund revenue collections that are in excess of the official estimates in the general appropriation act and ten percent of any unreserved general fund balance at the close of each fiscal year whose re-appropriation is not required in the general appropriation act. The Department administers the point source pollution control portion of the program. As of February 28, 2001, the Department has awarded \$74.05 million in reimbursement-basis grants for water quality improvement projects under 18 grant agreements.

To date, reimbursements total approximately \$35.8 million (or 48 percent of grants awarded). The following chart shows Water Quality Improvement Fund financial activity.

<u>Financial Activity - Fiscal Years 1998 through 2001</u>					
	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001*</u>	<u>Total</u>
Revenues					
General funds	\$10,000,000	\$37,100,000	\$25,244,294	\$10,300,000	\$82,644,294
Interest	<u>434,358</u>	<u>2,463,445</u>	<u>3,280,393</u>	<u>1,760,675</u>	<u>7,938,871</u>
Total revenues	10,434,358	39,563,445	28,524,687	12,060,675	90,583,165
Payments	<u>(2,688,177)</u>	<u>(5,673,418)</u>	<u>(14,828,232)</u>	<u>(12,632,560)</u>	<u>(35,822,387)</u>
Funds carried forward	<u>\$7,746,181</u>	<u>\$33,890,027</u>	<u>\$13,696,455</u>	<u>(\$571,885)</u>	<u>\$54,760,778</u>

* As of February 28, 2001

As shown above, more than \$54.7 million is available to support point source program objectives. The Department is currently negotiating eight new grant agreements, which are expected to cost an additional \$22.6 million. This, plus the \$38.2 million remaining under the original 18 grant agreements, will bring the Fund's total obligation to \$60.8 million.

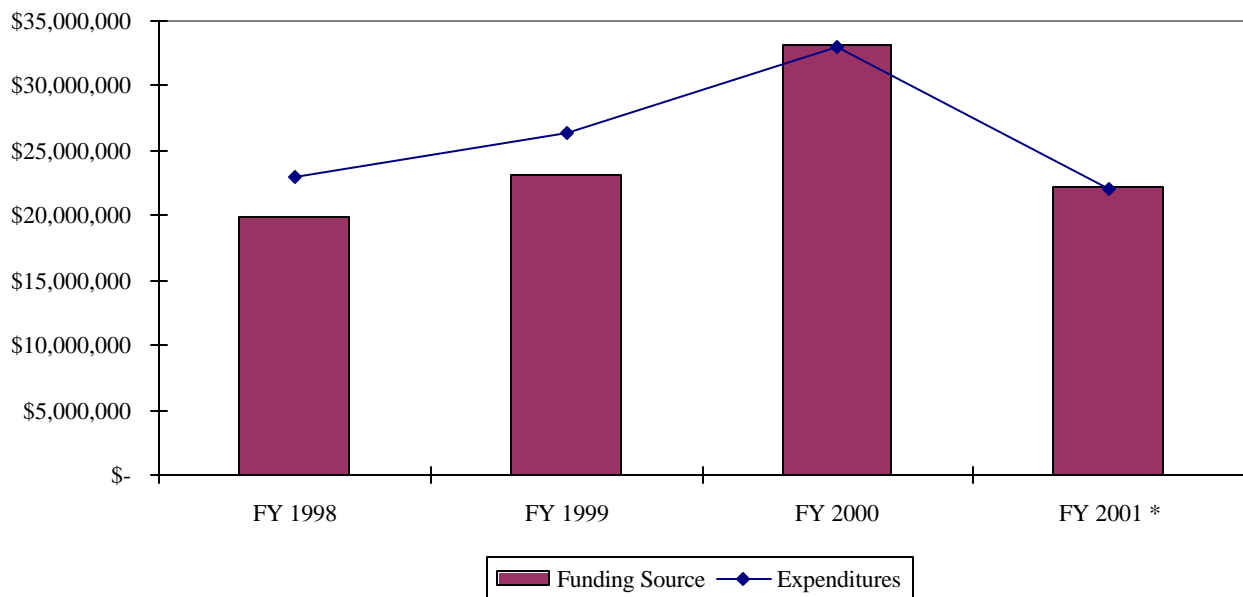
Title V Air Permitting Program

Title V of the Clean Air Act requires that each state develop a self-supporting operating permit program to apply state and federal requirements to stationary air pollution sources. The Environmental Protection Agency (EPA) granted interim approval for the Commonwealth's Title V program effective March 12, 1998. Virginia has submitted a Title V program final approval package to the EPA for consideration. As of June 30, 2000, the Department has granted 208 Title V air permits. In fiscal year 2000, Title V revenue and expenses totaled \$9,926,495 and \$7,541,178, respectively.

The Virginia Petroleum Storage Tank Fund

The Virginia Petroleum Storage Tank Fund reimburses approved clean-up costs and third-party damages resulting from petroleum releases from storage tanks. The primary revenue for the Fund comes from a per-gallon tax on regulated petroleum products sold in Virginia. Regulated products include gasoline, aviation motor fuel, diesel fuel, kerosene, and heating oil. As of February 28, 2001, there were 1,652 approved claims totaling \$22,219,530. The following graph shows Petroleum Storage Tank Fund financial activity over the last four years.

Financial Activity - Fiscal Years 1998 through 2001



* As of February 28, 2001

Because over the last several years, total expenses (\$104.6 million) have outpaced total revenues (\$98.4 million), the Department delays reimbursement payments for periods of up to eight months or more pending availability of funds. The Department attributes this situation to several reasons:

- An increase in the number of claims for residential releases.
- An increase in claims related to tank releases discovered near the December 1998 deadline for tank replacement.
- An increased public awareness of the possibility of reimbursement from the state.

For petroleum releases reported after March 31, 2001, the Department will defer payment on the first \$10,000 of approved costs indefinitely. The Department believes this will allow a wider distribution of available money among approved claims in the short-term. The Department has initiated a study to identify alternatives to permanently address the current imbalance between demand and revenue.

Status of Systems Development Projects

The Department continues its efforts to develop and implement new systems. The following is a listing of the significant systems projects.

Comprehensive Environmental Data System 2000 (CEDS 2000) - CEDS 2000 will provide functions for database management, application and issuance tracking, and compliance for the Department's permitting programs. When fully implemented, the system will run on Oracle and replace approximately 180 systems that run on various platforms. CEDS contains

three versions for implementation. Version 1, completed in December 1999, included all components essential for Y2K compliance. Current efforts focus on Version 2, which is scheduled for completion in the spring of 2001, and will include electronic submission of permit applications, discharge monitoring reports, and improvements to the Air Permit Generation System. Once completed, Version 2 will enable CEDS to interface with other systems such as the Internet Data Exchange Format (IDEF), which will increase efficiency. Version 3 will have Web-enabling and additional interfaces with other systems such as the Oracle Financial System. With the advancements and upgrades to Version 2, the Department is uncertain of the implementation date for Version 3. To date, the Department has spent approximately \$6.3 million on this project.

Oracle Financials - The Department acquired Oracle Financials to replace its legacy systems. The Department contracted with PricewaterhouseCoopers for implementation support services for five modules: General Ledger, Accounts Payables, Purchasing, Fixed Assets, and Accounts Receivable. The Department has also installed two other Oracle modules: Oracle Projects, a time reporting module, and Oracle Human Resources Management System (HRMS). Currently, the Department is upgrading to a browser-based system from the client server based system with an expected completion date of April 15, 2001. This upgrade also includes a web-enabled Oracle time sheet system, which will replace the current Personal Time and Expense module. This upgrade will also allow access from remote locations. To date, total costs for Oracle implementation and license fees are approximately \$2.3 million.

DEPARTMENT OF ENVIRONMENTAL QUALITY
Richmond, Virginia

Dennis H. Treacy
Director

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