



DEPARTMENT OF ENVIRONMENTAL QUALITY

REPORT ON AUDIT FOR THE YEARS ENDED JUNE 30, 2012 AND JUNE 30, 2013

AUDIT SUMMARY

Our audit of the Department of Environmental Quality for the fiscal years ended June 30, 2012, and 2013, found:

- proper recording and reporting of all transactions, in all material respects, in the Commonwealth Accounting and Reporting System;
- no matters involving internal control and its operation necessary to bring to management's attention; and
- no instances of noncompliance with applicable laws and regulations or other matters that are required to be reported.

–TABLE OF CONTENTS–

	<u>Pages</u>
AUDIT SUMMARY	
AGENCY HIGHLIGHTS	1-3
INDEPENDENT AUDITOR’S REPORT	4-5
AGENCY OFFICIALS	6

AGENCY HIGHLIGHTS

The Department of Environmental Quality (DEQ) protects the Commonwealth of Virginia's natural resources by administering state and federal environmental programs, issuing permits, monitoring water and air quality, and inspecting water facilities. Additionally, DEQ conducts extensive monitoring to ensure compliance with state and federal standards for water quality, air quality, and waste management. DEQ uses various funds to account for the collection and disbursement of program funding and we discuss some of the more significant funds below.

Water Quality Improvement Fund

The Water Quality Improvement Fund (WQIF) finances grant projects that protect and restore water quality across Virginia. DEQ and the Department of Conservation and Recreation jointly manage the WQIF. DEQ currently provides funding to publicly-owned treatment works for the purpose of designing and installing nutrient removal technology within the Chesapeake Bay watershed to control point source pollution. The Department of Conservation and Recreation provides funding to local governments, soil and water conservation districts, institutions of higher education, and individuals to lower the amount of non-point source pollution washed from the land throughout the Commonwealth. Beginning in fiscal year 2014, DEQ will assume full administrative control of the WQIF.

The WQIF receives funding from the General Fund and statutory funding as defined in the Code of Virginia, which requires 10 percent of annual statewide General Fund revenue collections that exceed the official estimates in the Appropriation Act, and 10 percent of any unreserved General Fund balance at the close of each fiscal year not mandated for re-appropriation go into the WQIF. Fifteen percent of mandatory deposits that result from General Fund surpluses are set aside in a reserve for appropriation in years when the Commonwealth does not have a General Fund budget surplus.

DEQ has 57 signed agreements, obligating about \$641 million in state funds, for the design and installation of nutrient reduction technology at Chesapeake Bay watershed point source discharges. This is largely due to the statutory requirement for DEQ to approve and enter into funding agreements with all eligible applicants. Applicants understand that WQIF funding is subject to appropriations by the General Assembly and may, at times be insufficient to meet the total of the signed agreement; and therefore, must ensure that they have sufficient sources of other funding to complete the project in the application.

Virginia Clean Water Revolving Loan Fund

The Virginia Clean Water Revolving Loan Fund provides a long-term renewable funding source for wastewater treatment improvement. The capitalization grant program, established by the Federal Water Quality Act, provides an annual source of federal funds for the loan fund. The loan fund offers long-term, low interest rate loans to local governments to construct or maintain infrastructures necessary to comply with the Clean Water Act requirements. DEQ contracts with the Virginia Resources Authority to manage the resources of the revolving loan fund, while DEQ retains the responsibility of reviewing and approving all disbursements of the fund.

During fiscal years 2013 and 2012, DEQ received \$22.8 million and \$35.9 million respectively, in federal funding. The funding is currently part of the revolving loan fund program and DEQ manages the disbursements accordingly.

The Virginia Petroleum Storage Tank Fund

The Virginia Petroleum Storage Tank Fund reimburses approved clean-up costs and some third-party damages resulting from petroleum releases from storage tanks. The primary revenue for the Fund comes from a \$.006 per gallon fee on regulated petroleum products sold in the Commonwealth. Regulated products include gasoline, aviation motor fuel, diesel fuel, kerosene, and heating oil.

FINANCIAL HIGHLIGHTS

DEQ receives funding from multiple sources including General Fund appropriations, special revenue funds, and federal grants. The tables below show DEQ's 2013 and 2012 original and final operating budgets and actual operating expenses by fund. There were significant changes between the original and final budget, and between the final budget and actual expenses, for both fiscal years.

During both fiscal years, the final budget was significantly larger than the original budget. This is primarily due to the variable funds received from the Water Quality Improvement Fund bond proceeds and adjustments to account for the Clean Water Revolving Loan Fund drawdowns from the Federal government.

Expenses during both fiscal years were also significantly below the budgeted amount. The primary reason is the nature of the Clean Water Revolving Loan Fund and changes in projects from year to year and the highly variable Water Quality Improvement Fund spending, which is also project-driven. Annual expenses are based on construction and billing schedules from dozens of project throughout the Commonwealth, which change from year to year.

Analysis of Budgeted and Actual Expenses by Fund for Fiscal Year 2013

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Expenses</u>
General Fund	\$ 118,069,077	\$ 32,842,368	\$ 32,840,822
Special Revenue Funds:			
Water Quality Improvement Fund	-	80,294,532	25,776,060
Petroleum Storage Tank Fund	36,925,181	36,869,731	32,854,500
Other*	28,247,759	30,990,271	25,494,815
Enterprise Fund	12,984,321	12,984,321	10,510,880
Federal Fund	44,511,482	23,058,385	18,996,487
Clean Water Revolving Loan Fund	453,988	27,537,085	22,970,017
WQIF – Bond Proceeds	-	<u>28,297,251</u>	<u>17,928,625</u>
Total	<u>\$ 241,191,808</u>	<u>\$272,873,944</u>	<u>\$187,372,206</u>

Analysis of Budgeted and Actual Expenses by Fund for Fiscal Year 2012

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Expenses</u>
General Fund	\$ 32,853,834	\$ 34,004,056	\$ 33,100,902
Special Revenue Funds:			
Petroleum Storage Tank Fund	37,027,944	37,015,419	32,779,465
Other*	28,214,697	28,073,049	23,369,061
Enterprise Fund	12,287,239	12,287,239	10,253,838
Federal Fund	44,424,917	22,973,267	18,409,752
ARRA Funds	-	4,578,754	2,688,077
Clean Water Revolving Loan Fund	-	46,873,498	36,017,386
WQIF – Bond Proceeds	-	<u>79,382,695</u>	<u>60,084,816</u>
Total	<u>\$154,808,631</u>	<u>\$265,187,977</u>	<u>\$216,703,297</u>

Source: Commonwealth Accounting and Reporting System, Chapters 890 and 3 of the Appropriation Act

**Includes other special revenue funds and trust and agency funds*

The Clean Water Revolving Loan Fund had either no or an insignificant original budget in either year because funding comes from a transfer of federal funds. DEQ draws down capitalization grant funds from the federal government during the year and then transfers funding to the Clean Water Revolving Loan Fund.

The following table compares DEQ's expenses by major category for fiscal years 2013 and 2012. Transfer payments to local governments and other entities are DEQ's largest expense; accounting for about 62 percent of total expenses in both fiscal years 2013 and 2012, which primarily reflects the amount paid for Virginia Water Quality Improvement Fund and Clean Water Revolving Loan Fund projects.

<u>Expenses by Major Category</u> (in thousands)		
	<u>2013</u>	<u>2012</u>
Payments to Local Governments and Other Entities:		
Water Quality Improvement Fund & Bond Proceeds	\$ 17,928,625	\$ 60,084,816
Clean Water Revolving Loan Fund	22,240,801	35,502,415
Clean Water Revolving Loan Fund - ARRA	-	1,508,338
Petroleum Storage Tank Fund	23,998,046	23,725,463
Other Transfer Payments	<u>43,490,706</u>	<u>20,304,696</u>
Total transfer payments	<u>107,658,178</u>	<u>141,125,728</u>
Personal Services	59,515,513	57,087,249
Contractual Services	14,032,270	12,155,989
Other	<u>6,166,245</u>	<u>6,334,331</u>
Total	<u>\$187,372,206</u>	<u>\$216,703,297</u>

Source: Commonwealth Accounting and Reporting System

Total expenses decreased by about \$29.3 million in fiscal 2013. This is almost entirely attributable to the variable nature of the Clean Water Revolving Loan Fund and the WQIF, where expenses fluctuate from year to year depending on the number of projects.



Commonwealth of Virginia

Auditor of Public Accounts

Martha S. Mavredes, CPA
Auditor of Public Accounts

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October 1, 2013

The Honorable Robert F. McDonnell
Governor of Virginia

The Honorable John M. O'Bannon, III
Chairman, Joint Legislative Audit
and Review Commission

We have audited the financial records and operations of the **Department of Environmental Quality (DEQ)** for the years ended June 30, 2012, and 2013. 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 based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Audit Objectives

Our audit's primary objectives were to evaluate the accuracy of recorded financial transactions in the Commonwealth Accounting and Reporting System, review the adequacy of DEQ's internal controls, and test compliance with applicable laws, regulations, contracts, and grant agreements.

Audit Scope and Methodology

DEQ'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, regulations, contracts, and grant agreements.

We gained an understanding of the overall internal controls, both automated and manual, sufficient to plan the audit. We considered significance and risk in determining the nature and extent of our audit procedures. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances.

- Federal grant revenues and expenses
- Transfer payments
- Contractual services expenses
- Payroll expenses
- Small purchase charge card
- Appropriations
- Cash receipts
- Information system security

We performed audit tests to determine whether DEQ'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, regulations, contracts, and grant agreements. Our audit procedures included inquiries of appropriate personnel, inspection of documents, records, and contracts, and observation of DEQ's operations. We tested transactions and performed analytical procedures, including budgetary and trend analyses.

Conclusions

We found that the Department of Environmental Quality properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System. DEQ records its financial transactions on the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. 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 consider necessary to be reported to management. The results of our tests of compliance with applicable laws, regulations, contracts, and grant agreements disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

Exit Conference and Report Distribution

We discussed this report with management on October 18, 2013.

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

AUDITOR OF PUBLIC ACCOUNTS

JGF/alh

DEPARTMENT OF ENVIRONMENTAL QUALITY

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