

DEPARTMENT OF ENVIRONMENTAL QUALITY

**REPORT ON AUDIT
FOR THE YEARS ENDED
JUNE 30, 2006 AND JUNE 30, 2007**



AUDIT SUMMARY

Our audit of the Department of Environmental Quality, found:

- proper recording and reporting of all transactions, in all material respects, in the Commonwealth Accounting and Reporting System;
- one matter involving internal control and its operations necessary to bring to management's attention; and
- one instance of noncompliance with applicable laws and regulations or other matters that are required to be reported.

Risk alerts are issues beyond the corrective action of management and require the action of either another agency or outside party or a change in the method by which the Commonwealth conducts its operations. The following matter represents a risk to the Department, but the Department must rely on the Virginia Information Technologies Agency to address the risk.

- Security Risk Assurance for Infrastructure

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COMMENTS TO MANAGEMENT

Risk Alert

During the course of our audits, we encounter issues, which are beyond the corrective action of management and require the action of either another agency or outside party or a change in the method by which the Commonwealth conducts its operations. The following matter represents a risk to the Department of Environmental Quality, but the Department must rely on the Virginia Information Technologies Agency (VITA) to address the risk.

Security Risk Assurance for Infrastructure

The Department of Environmental Quality (Environmental Quality) has responsibility for the security and safeguarding of all of their information technology systems and information. Over the past four years, the Commonwealth has moved the information technology infrastructure supporting these databases to the Virginia Information Technologies Agency (VITA), who has an Information Technology Partnership (IT Partnership) with Northrop Grumman. In this environment, VITA and Environmental Quality clearly share responsibility for the security of Environmental Quality's information technology assets, systems, and information and must provide mutual assurance of this safeguarding.

Environmental Quality has provided VITA with all the documentation required to make this assessment and VITA should provide assurance that the IT Partnership will practice proper policies and procedures as outlined by Environmental Quality. The annual review and audit of the IT Partnership infrastructure has concluded, and VITA will communicate any findings and corrective action to Environmental Quality.

VITA has provided Environmental Quality with a corrective action plan identifying Environmental Quality's vulnerabilities and corresponding remediation actions. This corrective active plan is critical in order to minimize the security risks relating to the confidentiality, integrity, and availability of Environmental Quality's information stored on the IT Partnership's hardware and infrastructure. Environmental Quality should collaborate with the IT Partnership to ensure that the remediation actions to be implemented are adequate and completed in the timeframe specified.

Environmental Quality should request regular status reports from VITA on the progress the IT Partnership is making to correct the issues for which they are responsible. As part of the progress reporting, VITA should provide Environmental Quality with any interim steps they should take if the IT Partnership must delay addressing these issues. We bring this matter to the attention of Environmental Quality, so that they can properly manage their risk and monitor corrective action.

AUDIT FINDINGS AND RECOMMENDATIONS

Properly Complete Employment Eligibility Verification Forms

The Department of Environmental Quality (Environmental Quality) is not properly completing Employment Eligibility Verification forms (I-9) in accordance with guidance issued by the US Citizenship and Immigration Services of the US Department of Homeland Security in its Handbook for Employers (M-274). This guidance requires the employee complete, sign, and date Section 1 of the I-9 on or before the first day of employment. Additionally, the employer or designated representative must complete, sign, and date Section 2 of the I-9 within three days of employment to show that they verified the employee's identity and employment eligibility at the point of hiring.

In our sample of eight I-9 forms completed during fiscal year 2007, we noted the following non-compliance:

- One did not have the employee sign the form by the first date of employment;
- One did not document the first day of employment; and
- Five did not properly list the documents used to verify the employee's identity and employment eligibility on the forms.

We found that the errors were due to an inadequate agency specific policy regarding the I-9 forms; however, other supporting documentation was present despite these exceptions. Therefore, we recommend that Environmental Quality develop procedures, train the appropriate staff on the requirements of completing I-9s, and develop a process for continuously reviewing Environmental Quality's I-9 process to ensure compliance with federal regulations. The federal government has increased its enforcement efforts to ensure that all new employees are legally entitled to work in the United States, which makes having a good I-9 process in place more important than ever before.

AGENCY HIGHLIGHTS

The Department of Environmental Quality (Environmental Quality) 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, Environmental Quality conducts extensive monitoring to ensure compliance with state and federal standards for water quality, air quality, and waste management. Environmental Quality also enforces regulations promulgated by the State Water Control Board, the Board of Waste Management, and the Air Pollution Control Board.

Environmental Quality operates through its central office, seven regional offices, and three satellite and specialized offices. Major operations involve technical and financial assistance to communities and businesses to protect environmental resources; permit, compliance and response programs for air, land, and water resources; and management of remediation and response programs.

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. In fiscal year 2006, Virginia Petroleum Storage Tank Fund had revenue and expenses of approximately \$37.1 million and \$35.3 million respectively. In fiscal year 2007, revenue and expenses were \$35.9 million and \$37.2 million respectively.

Virginia Revolving Loan Fund

In 1986, the Virginia General Assembly created the Virginia Clean Water Revolving Loan Fund to provide a long-term renewable funding source for wastewater treatment improvement. The Federal Water Quality Act of 1987 established a capitalization grant program that 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.

Environmental Quality contracts with the Virginia Resource Authority to manage the resources of the revolving loan fund while Environmental Quality retains the responsibility of reviewing and approving all disbursements of the fund. During fiscal years 2006 and 2007, the fund received and loaned \$26,411,623, and \$19,802,338 respectively in new federal funds to local governments through Environmental Quality. Additionally during fiscal years 2006 and 2007, the revolving loan fund distributed another \$71,903,438 and \$95,843,028 respectively in loans to local governments from loan repayments received by the Virginia Resource Authority. These "second generation" loans are not in Environmental Quality's financial highlights, as the Virginia Resource Authority collects and redistributes the funds on behalf of Environmental Quality.

Virginia Water Quality Improvement Fund

In 1997, the Commonwealth established a special permanent fund known as the "Virginia Water Quality Improvement Fund" to finance nutrient removal strategies for the Chesapeake Bay and its tributaries. The Virginia Water Quality Improvement Fund receives funds from the General Fund, as appropriated by the General Assembly, and statutory funding as provided in the Code of Virginia. The Code of Virginia requires that ten percent of the annual statewide General Fund revenue collections, which exceed the official estimates in the General Appropriation Act, and ten percent of any unreserved statewide General Fund balance at the close of each fiscal year not mandated for re-appropriation go into the fund. 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.

Environmental Quality and the Department of Conservation and Recreation jointly manage the Virginia Water Quality Improvement Fund. Environmental Quality provides funding to publicly-owned treatment works for the purpose of designing and installing biological nutrient removal facilities 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 within the Chesapeake Bay watershed. Of the fund's total expenses, Environmental Quality spent \$2.8 million and \$20.9 million, for fiscal years 2006 and 2007 respectively, on point source pollution, and the Department of Conservation and Recreation spent \$10.2 million in 2006 and \$14.4 million in 2007 on non-point source pollution.

FINANCIAL HIGHLIGHTS

The following table shows Environmental Quality's original budget, final budget, and actual expenses. In fiscal year 2006, the General Fund final budget increased after receiving additional general funds for the Water Quality Improvement Fund, a special revenue fund. Environmental Quality did not spend the funds immediately because of a time lag in obligating and disbursing monies. Environmental Quality is currently making awards for biological nutrients reduction facilities and water treatment plants.

Project expenses continue to increase every fiscal year, but project construction has not begun at this point. Since this is the beginning of a large project, the expenditures are less during the first years of planning; however, over the next 13 years, this project has an estimated cost of approximately \$900 million. This time lag in the disbursing of funds caused a variance between final budget and actual expenses in both fiscal years.

<u>Budget to Actual Funding Analysis</u>						
	<u>2007</u>			<u>2006</u>		
	<u>Original</u>	<u>Final</u>	<u>Actual</u>	<u>Original</u>	<u>Final</u>	<u>Actual</u>
General fund	\$255,083,523	\$ 43,373,140	\$ 42,912,548	\$108,199,408	\$ 43,989,960	\$ 43,775,615
Enterprise fund	10,808,736	10,808,736	10,591,179	12,000,000	12,319,134	11,137,020
Special revenue fund	73,227,304	272,378,269	78,184,234	60,608,486	149,716,507	63,869,882
Federal trust	42,148,215	42,124,215	36,641,658	45,379,306	49,859,807	46,421,287
Trust fund	-	546,229	67,500	-	1,656,372	1,110,144
Total	<u>\$381,267,778</u>	<u>\$369,230,589</u>	<u>\$168,397,119</u>	<u>\$226,187,200</u>	<u>\$257,541,780</u>	<u>\$166,313,948</u>

Source: Commonwealth Accounting and Reporting System

The next table shows Environmental Quality's expenses by major categories with its largest category, transfer payments, making up 46 percent and 50 percent for fiscal years 2006 and 2007 respectively. This category is broken into subcategories to illustrate the different mechanisms used to provide assistance to other entities.

Expenses by Major Category

	<u>2007</u>	<u>2006</u>
Personal services	\$ 58,185,931	\$ 57,653,070
Contractual services	18,697,638	25,153,113
Supplies and materials	744,201	652,198
Transfer payments:		
Underground Storage Tank Fund	27,394,883	25,429,606
Water Quality Improvement Fund	20,908,814	2,811,766
Clean Water Revolving Loan Fund	19,777,811	25,671,966
Incentives to recycle waste tires	2,099,812	1,639,882
Other grants and financial assistance	8,031,692	13,830,094
Litter Control and Recycling Fund	1,497,268	1,961,429
Other transfer payments	<u>4,775,226</u>	<u>5,370,490</u>
 Total transfer payments	 <u>84,485,506</u>	 <u>76,715,233</u>
 Continuous charges	 4,979,839	 4,855,472
Property and improvements	8,992	1,184
Equipment	1,293,562	1,282,929
Plant and improvements	<u>1,450</u>	<u>750</u>
 Total	 <u>\$ 168,397,119</u>	 <u>\$166,313,949</u>

Source: Commonwealth Accounting and Reporting System

Contractual services were 25 percent higher in fiscal year 2006 because of the initiative to clean waste tire piles in the Waste Tire Pile Clean Up Program. This program seeks to transform the waste tire management system by increasing recycling levels. The Clean Water Revolving Loan Fund expenses decreased by approximately 23 percent during fiscal year 2007 because there was a lag in expenses inherent to construction project grants. This lag is normal, as some of the project awards are for larger projects which incur fewer expenses at the beginning during the planning phase. Above is the explanation of the Water Quality Improvement Fund change in expenses.



Commonwealth of Virginia

Walter J. Kucharski, Auditor

**Auditor of Public Accounts
P.O. Box 1295
Richmond, Virginia 23218**

March 10, 2008

The Honorable Timothy M. Kaine
Governor of Virginia
State Capital
Richmond, Virginia

The Honorable Thomas K. Norment, Jr.
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

We have audited the financial records and operations of the **Virginia Department of Environmental Quality** (Environmental Quality) for the years ended June 30, 2006, and June 30, 2007. We conducted this performance audit in accordance with generally accepted Government Auditing Standards, issued by the Comptroller General of the United States. 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 on the Commonwealth Accounting and Reporting System, review the adequacy of Environmental Quality's internal controls, and test compliance with applicable laws and regulations.

AUDIT SCOPE AND METHODOLOGY

Environmental Quality'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.

We gained an understanding of the overall internal controls, both automated and manual, sufficient to plan the audit. We considered materiality and control 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.

Clean Water Revolving Loan Fund revenues and expenditures
Revenue from fees and other federal grants

Payroll expenditures
Network security
Other transfer payments and contractual services

Our audit did not include the physical security of the Commonwealth Enterprise Solutions Center, where Environmental Quality's system infrastructure is housed, as it is owned by Northrop Grumman Corporation and auditing of physical security is the responsibility of their external auditors.

We performed audit tests to determine whether Environmental Quality'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. Our audit procedures included inquiries of appropriate personnel; inspection of project files, grant agreements, payroll records, vouchers, deposit certificates, contracts, and system security documents; and observation of Environmental Quality's operations. We tested transactions and performed analytical procedures, including budgetary and trend analyses.

CONCLUSIONS

We found that Environmental Quality properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System. Environmental Quality 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 a matter involving internal control and its operation and compliance with applicable laws and regulations that require management's attention and corrective action. This matter is described in the section entitled "Audit Findings and Recommendations."

EXIT CONFERENCE AND REPORT DISTRIBUTION

We discussed this report with management on March 18, 2008. Management's response has been included at the end of this report.

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

AVG/wdh



COMMONWEALTH of VIRGINIA

DEPARTMENT OF ENVIRONMENTAL QUALITY

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March 25, 2008

Mr. Walter J. Kucharski
Auditor of Public Accounts
P.O. Box 1295
Richmond, Virginia 23218

Thank you for the opportunity to respond to the Management Risk Alert and also the audit finding regarding our Employment Eligibility Verification Forms (I-9) processing detailed in DEQ's Fiscal year 2006 and 2007 audit report.

First, with regards to the Risk Alert, management within DEQ takes information security very seriously. DEQ staff and management have spent much time and effort over the past two years implementing security policies and documenting security procedures for compliance with COV ITRM Policies. During this process, DEQ has collaborated with VITA/NG staff on areas under the VITA partnership's responsibility. DEQ does meet weekly with VITA/NG staff and as a result of this alert, will ensure all security issues and corrective action plans are discussed and approved by DEQ management. In addition, periodic reviews of existing policies and practices outlined in VITA's Letter of Assurance will be performed with VITA/NG staff to ensure policies and practices are still being followed.

Second, with regards to I-9 processing I would like to recap DEQ's process for completing I-9's for new employees:

- After an applicant accepts a position, we state in our offer letters: "The Immigration Reform and Control Act of 1986 requires employers to verify employee identity and U.S. employment eligibility, whether U.S. citizen or not. As such, you must present original (not photocopied) documents for verification when you arrive on your first day. Please review the enclosed list of other acceptable documents."
- On an employee's first day of work, Human Resources (HR) or the HR representative in our Regional Offices (Office Manager) meets with the employee, as part of the New Employee Orientation process, to complete all necessary payroll paperwork which

includes the completion of the I-9 form. The original documents are copied and attached to the form and certified by HR or the Office Manager and then filed in a separate filing system in the HR Office. If the I-9 form is completed in the regions, this process is followed, a faxed copy is sent immediately to HR and the originals are placed in the mail to HR.

- If the employee does not have proof of eligibility, including their social security card, within 3 workdays, they are sent home until proof is provided. (This has happened on one occasion and the above procedure was followed). We will accept a receipt from the Social Security Administration, stating that they applied for a new Social Security Card and they are eligible to receive the card.

As a result of the audit finding, DEQ has also taken the following steps to ensure compliance with federal requirements:

- An I-9 procedure has been developed and all staff responsible for completing the I-9 forms on an employee's first day of hire have been trained in the proper procedure;
- All staff responsible for completing I-9 forms are required to take the Department of Accounts (DOA) PowerPoint training on the proper completion and retention of I-9 forms;
- DEQ has put in place a quality assurance procedure for I-9 processing. Once an I-9 form is completed and sent to HR, an HR team leader reviews the form to ensure all documentation is accurate and that the form is completed in its entirety.

I would also like to thank you for the professionalism demonstrated by your audit staff and the thoroughness of their work.

Sincerely,



Valerie E. Thomson
Director of Administration

AGENCY OFFICIALS

DEPARTMENT OF ENVIRONMENTAL QUALITY

David K. Paylor, Director

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