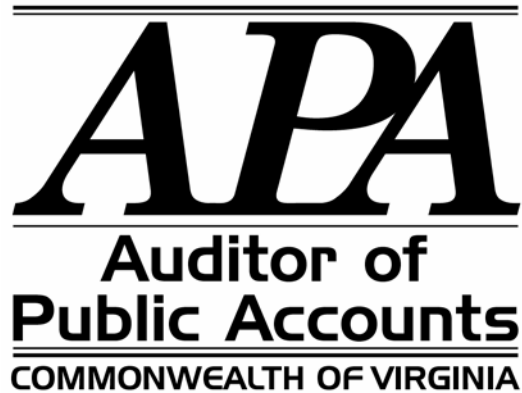


DEPARTMENT OF ENVIRONMENTAL QUALITY

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2005**



AUDIT SUMMARY

Our audit of the Department of Environmental Quality for the year ended June 30, 2005, found:

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

- TABLE OF CONTENTS -

	<u>Pages</u>
AUDIT SUMMARY	
AGENCY HIGHLIGHTS	1-2
FINANCIAL HIGHLIGHTS	2-3
INDEPENDENT AUDITOR'S REPORT	4-5
AGENCY OFFICIALS	6

AGENCY HIGHLIGHTS

The Department of Environmental Quality (Environmental Quality) protects the Commonwealth of Virginia's (Commonwealth) natural resources by administering state and federal environmental programs, issuing permits, monitoring water and air quality, and inspecting waste 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 2005, Virginia Petroleum Storage Tank Fund had revenue and expenses of approximately \$38 million.

Virginia Revolving Loan Fund

The 1986 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 year 2005, the fund received and loaned \$23 million in new federal funds to local governments through Environmental Quality. Additionally during fiscal year 2005, the revolving loan fund distributed another \$70 million 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. Of the fund's total statewide expenses, \$10,555,326, during fiscal year 2005 the Environmental Quality provided 55 percent 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. Whereas, the Department of Conservation and Recreation provided 43 percent 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. In addition, during fiscal year 2005 the Department of Health accounted for less than one percent of the fund's statewide expenses.

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 Section 10.1-2128 of 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. In fiscal year 2006, Environmental Quality, received an additional appropriation to transfer \$50 million from the General Fund to Virginia Water Quality Improvement Fund to finance the costs of installing biological nutrient removal technology at publicly owned treatment works.

FINANCIAL HIGHLIGHTS

The following table shows Environmental Quality's original budget, final budget, and actual funding by fund source. The General Fund decreased and the special revenue fund increased primarily due to a transfer of \$13 million to the Water Quality Improvement Fund. Management increased the budget for the special revenue fund to cover the cost of new desktop computers for agency employees. The federal fund increased due to an increase in projected project costs that did not materialize within fiscal year 2005.

<u>Budget and Actual Funding Analysis</u>			
<u>2005</u>			
	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual Funding</u>
General fund	\$ 49,522,747	\$ 36,866,105	\$ 36,866,105
Enterprise fund	12,000,000	12,070,800	9,967,899
Special revenue fund*	60,690,930	77,142,307	63,521,726
Federal trust	45,347,698	50,893,885	40,648,698
Trust fund	-	2,300,000	-
Total	<u>\$167,561,375</u>	<u>\$179,273,097</u>	<u>\$151,004,428</u>

* includes both special revenue and dedicated special revenue funds

Source: Commonwealth Accounting and Reporting System (CARS)

Note: Fund classifications were adjusted to mirror those used in the Comptroller's Comprehensive Annual Financial Report.

The table below shows Environmental Quality's expenses by program as compared to the program's original and final budgets. The Environmental Technical and Financial Assistance program increased due to the increases of \$13 million in the Water Quality Improvement Fund and \$5 million from federal fund balances re-appropriated from the prior year.

<u>Budget and Actual Expense Analysis by Program</u>			
<u>2005</u>			
	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual Expenses</u>
Administrative and support services	\$ 19,202,376	\$ 21,936,323	\$ 20,586,938
Environmental resources management	35,495,230	33,428,235	30,598,600
Environmental research and planning	7,839,506	8,154,109	6,764,246
Environmental monitoring and evaluation	8,050,865	8,586,477	8,331,428
Environmental technical and financial assistance	52,803,091	61,628,692	45,110,761
Environmental policy and program development	251,907	392,907	282,107
Environmental information, education and assistance	3,456,630	3,760,916	1,996,429
Environmental response and remediation	40,461,770	41,385,438	39,888,926
Total	<u>\$167,561,375</u>	<u>\$179,273,097</u>	<u>\$153,559,435</u>

Source: CARS

The next table shows Environmental Quality's expenses by major categories with its largest category, transfer payments \$75 million in total (49 percent), broken into subcategories to illustrate the different mechanisms used to provide assistance to other entities.

<u>Expenses by Major Categories</u>		<u>2005</u>
Personal services		\$ 51,366,818
Environmental monitoring, remediation and other contractual services		17,928,418
Transfer payments:		
Petroleum storage tank clean up	28,548,329	
Clean Water Revolving Loan Fund**	28,008,650	
Water Quality Improvement Fund	4,861,831	
Incentives to recycle waste tires	3,130,643	
Other grants and financial assistance	5,773,649	
Other transfer payments	5,169,055	
Total transfer payments		75,492,157
Continuous charges		4,884,844
Supplies and materials		544,006
Property, plant, and equipment		<u>3,343,192</u>
Total		<u>\$153,559,435</u>

Source: CARS

** includes \$22,669,048 federal funds and \$5,339,602 general fund match



Commonwealth of Virginia

Walter J. Kucharski, Auditor

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

May 1, 2006

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

The Honorable Lacey E. Putney
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

INDEPENDENT AUDITOR'S REPORT

We have audited selected financial records and operations of the **Department of Environmental Quality** (Environmental Quality) for the year ended June 30, 2005. We conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

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 the Agency's internal controls, and test compliance with applicable laws and regulations.

Audit Scope and Methodology

The Department of 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 the agency's significant business cycles 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.

- Payroll expenditures
- Contractual services expenditures
- Transfer payments
- Capitalization Grants for Clean Water State Revolving Funds
- Virginia Water Quality Improvement Fund
- Information Systems Security

We performed audit tests to determine whether the Agency'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 documents, payroll records, and contracts, walkthroughs of significant cycle processes, and observation of the Agency's operations. We tested transactions and performed analytical procedures, including budgetary and trend analyses.

Audit Conclusions

We found that the Agency properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System. The Agency 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 and regulations 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 May 19, 2006. 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; and its distribution is not limited.

AUDITOR OF PUBLIC ACCOUNTS

GDS:sks
sks: 47

AGENCY OFFICIALS

DEPARTMENT OF ENVIRONMENTAL QUALITY

David K. Paylor, Director

STATE BOARD OF WASTE MANAGEMENT

Robert G. Crockett	Hunter H. McGuire III
Donald L. Williams	Eric K. Sildon
N. Howard Burns, Jr.	Clarence M. Dunnville, Jr.

Betty Byrne Ware

STATE AIR POLLUTION CONTROL BOARD

Richard D. Langford, Chairman

Hullihen Williams Moore	Smita Siddhanti
Vivian E. Thomson	John N. Hanson

STATE WATER CONTROL BOARD

Carol C. Wampler, Chairman

W. Shelton Miles	W. Jack Kiser
Komal K. Jain	E. Bryson Powell
Michael McKenney	Thomas D. C. Walker