MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT

FINANCIAL AUDIT
INCLUDING THE PROVISIONS OF THE SINGLE AUDIT ACT
OF THE

DEPARTMENT OF ENVIRONMENTAL QUALITY

October 1, 2003 through September 30, 2005

THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

76-100-06

"...The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof."

– Article IV, Section 53 of the Michigan Constitution

Audit report information may be accessed at:
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Michigan

Office of the Auditor General

REPORT SUMMARY

Financial Audit

Including the Provisions of the Single Audit Act

Report Number:
76-100-06

Department of Environmental Quality

October 1, 2003 through September 30, 2005

Released:
June 2006

A Single Audit is designed to meet the needs of all financial report users, including an entity's federal grantor agencies. The audit determines if the financial schedules and/or financial statements are fairly presented; considers internal control over financial reporting and internal control over federal program compliance; determines compliance with State compliance requirements material to the financial schedules and/or financial statements; and assesses compliance with direct and material requirements of the major federal programs.

Financial Statements and Financial Schedules:

Auditor's Reports Issued

We issued unqualified opinions on the Department of Environmental Quality's (DEQ's) financial statements and financial schedules.

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Internal Control Over Financial Reporting

We did not report any findings related to internal control over financial reporting.

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Noncompliance or Other Matters Material to the Financial Statements and/or Financial Schedules

We did not identify any instances of noncompliance or other matters applicable to the financial statements and/or financial schedules that are required to be reported under *Government Auditing Standards*.

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Federal Awards:

Auditor's Reports Issued on Compliance

We audited 8 programs as major programs and issued 8 unqualified opinions. The federal programs audited as major programs are identified on the back of this summary.

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Internal Control Over Major Programs

We did not identify any material weaknesses in internal control over major programs. However, we did identify reportable conditions (Findings 1 and 2).

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Required Reporting of Noncompliance

We identified instances of noncompliance that are required to be reported in accordance with U.S. Office of Management and Budget (OMB) Circular A-133 (Finding 2).

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Systems of Accounting and Internal Control:
We determined that DEQ was in substantial compliance with Sections 18.1483 - 18.1487 of the *Michigan Compiled Laws*.

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We audited the following programs as major programs:

CFDA Number	***Program Title***	***Compliance Opinion***
11.419	Coastal Zone Management Administration Awards	Unqualified
66.001	Air Pollution Control Program Support	Unqualified
66.419	Water Pollution Control State and Interstate Program Support	Unqualified
66.432	State Public Water System Supervision	Unqualified
66.458	Capitalization Grants for Clean Water State Revolving Funds	Unqualified
66.460	Nonpoint Source Implementation Grants	Unqualified
66.801	Hazardous Waste Management State Program Support	Unqualified
66.802	Superfund State, Political Subdivision, and Indian Tribe Site-Specific Cooperative Agreements	Unqualified

A copy of the full report can be obtained by calling 517.334.8050 or by visiting our Web site at: http://audgen.michigan.gov

Michigan Office of the Auditor General
201 N. Washington Square
Lansing, Michigan 48913

Thomas H. McTavish, C.P.A.
Auditor General

Scott M. Strong, C.P.A., C.I.A.
Deputy Auditor General

STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
FAX (517) 334-8079

THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

June 28, 2006

Mr. Steven E. Chester, Director
Department of Environmental Quality
Constitution Hall
Lansing, Michigan

Dear Mr. Chester:

This is our report on the financial audit, including the provisions of the Single Audit Act, of the Department of Environmental Quality (DEQ) for the period October 1, 2003 through September 30, 2005.

This report contains our report summary; our independent auditor's reports on the financial statements and financial schedules; and the DEQ financial statements and financial schedules, notes to the financial statements and financial schedules, and supplemental financial statements and financial schedule. This report also contains our independent auditor's report on internal control over financial reporting and on compliance and other matters, our independent auditor's report on compliance with requirements applicable to each major program and on internal control over compliance in accordance with U.S. Office of Management and Budget Circular A-133, and our schedule of findings and questioned costs. In addition, this report contains DEQ's summary schedule of prior audit findings, its corrective action plan, and a glossary of acronyms and terms.

Our findings and recommendations are contained in Section III of the schedule of findings and questioned costs. The agency preliminary responses are contained in the corrective action plan. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

We appreciate the courtesy and cooperation extended to us during this audit.

AUDITOR GENERAL

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INDEPENDENT AUDITOR'S REPORTS, FINANCIAL STATEMENTS, AND FINANCIAL SCHEDULES

STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
FAX (517) 334-8079

THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on
the Financial Statements

Mr. Steven E. Chester, Director
Department of Environmental Quality
Constitution Hall
Lansing, Michigan

Dear Mr. Chester:

We have audited the accompanying financial statements of the Department of Environmental Quality as of and for the fiscal years ended September 30, 2005 and September 30, 2004, as identified in the table of contents. These financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1, the financial statements present only the Department of Environmental Quality's special revenue and agency funds and do not purport to, and do not, present fairly the financial position of the State of Michigan or its special revenue and agency funds as of September 30, 2005 and September 30, 2004 and the changes in financial position thereof for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Department of Environmental Quality's special revenue and agency funds as of September 30, 2005 and September 30, 2004 and the changes in financial position for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 24, 2006, except for Note 8 as to which the date is May 25, 2006 and Note 9a as to which the date is May 17, 2006, on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The schedule of expenditures of federal awards, required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Nonprofit Organizations*, and the supplemental financial statements, as identified in the table of contents, are presented for purposes of additional analysis and are not a required part of the Department's financial statements referred to in the first paragraph. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

AUDITOR GENERAL

March 24, 2006, except for Note 8 as to which the date is May 25, 2006 and Note 9a as to which the date is May 17, 2006

STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
FAX (517) 334-8079

THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on the Financial Schedules

Mr. Steven E. Chester, Director
Department of Environmental Quality
Constitution Hall
Lansing, Michigan

Dear Mr. Chester:

We have audited the accompanying financial schedules of the Department of Environmental Quality for the fiscal years ended September 30, 2005 and September 30, 2004, as identified in the table of contents. These financial schedules are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial schedules based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial schedules. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1, the financial schedules present only the revenues and other financing sources and the sources and disposition of authorizations for the Department of Environmental Quality's General Fund accounts, presented using the current financial resources measurement focus and the modified accrual basis of accounting. Accordingly, these financial schedules do not purport to, and do not, constitute a complete financial presentation of either the Department or the State's General Fund in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial schedules referred to in the first paragraph present fairly, in all material respects, the revenues and other financing sources and the sources and disposition of authorizations of the Department of Environmental Quality for the fiscal years ended September 30, 2005 and September 30, 2004 on the basis of accounting described in Note 1.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 24, 2006, except for Note 8 as to which the date is May 25, 2006 and Note 9a as to which the date is May 17, 2006, on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of the internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The schedule of expenditures of federal awards, required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, is presented for purposes of additional analysis and is not a required part of the Department's financial schedules referred to in the first paragraph. Such information has been subjected to the auditing procedures applied in the audit of the financial schedules and, in our opinion, is fairly stated, in all material respects, in relation to the financial schedules taken as a whole.

AUDITOR GENERAL

March 24, 2006, except for Note 8 as to which the date is May 25, 2006 and Note 9a as to which the date is May 17, 2006

DEPARTMENT OF ENVIRONMENTAL QUALITY
Combined Balance Sheet
As of September 30
(In Thousands)

	Special Revenue Funds		Agency Fund	
	2005	2004	2005	2004
ASSETS				
Current Assets:				
Cash	$ 5	$	$	$
Equity in common cash	157,840	181,716	2,775	2,875
Taxes, interest, and penalties receivable (Note 6)		6,554		
Amounts due from component units	11	8		
Amounts due from local units	1,238	953		
Other current assets	1,019	2,725		
Total Current Assets	$ 160,113	$ 191,956	$ 2,775	$ 2,875
Amounts due from local units	4,289	3,550		
Other noncurrent assets	1,385	1,539		
Total Assets	$ 165,787	$ 197,044	$ 2,775	$ 2,875
LIABILITIES AND FUND BALANCES				
Current Liabilities:				
Warrants outstanding	$ 578	$ 485	$	$
Accounts payable and other liabilities	34,344	30,762	2,775	2,875
Amounts due to other funds (Note 6)	168	5,822		
Deferred revenue	245	1,073		
Total Current Liabilities	$ 35,335	$ 38,142	$ 2,775	$ 2,875
Long-Term Liabilities:				
Deferred revenue	1,385	1,539		
Total Liabilities	$ 36,720	$ 39,681	$ 2,775	$ 2,875
Fund Balances:				
Reserves for:				
Budgetary carry-forwards (Note 2):				
Encumbrances	$ 3,247	$ 2,663	$	$
Restricted revenues	42,655	75,624		
Multi-year projects	7,997	5,770		
Revolving loan programs	20,569	20,502		
Funds held as permanent investments (Note 8)	23,369	21,400		
Total Reserved	$ 97,838	$ 125,959	$ 0	$ 0
Unreserved	31,229	31,405		
Total Fund Balances	$ 129,067	$ 157,363	$ 0	$ 0
Total Liabilities and Fund Balances	$ 165,787	$ 197,044	$ 2,775	$ 2,875

The accompanying notes are an integral part of the financial statements.

DEPARTMENT OF ENVIRONMENTAL QUALITY
Combined Statement of Revenues, Expenditures, and Changes in Fund Balances
Fiscal Years Ended September 30
(In Thousands)

	Special Revenue Funds	
	2005	2004
REVENUES		
Taxes (Note 6)	$	$ 59,575
Federal	178	
Interest and other miscellaneous	26,104	27,582
Total Revenues	$ 26,281	$ 87,157
EXPENDITURES		
Current:		
General government	$ 944	$ 156
Health services	6	316
Environmental	107,536	95,816
Total Expenditures	$ 108,485	$ 96,289
Excess of Revenues Over (Under) Expenditures	$ (82,204)	$ (9,131)
OTHER FINANCING SOURCES (USES)		
Proceeds from bond issues	$ 64,935	$ 54,515
Premium on bond issuance	6,577	
Transfers from other funds		15,004
Transfers to other funds (Note 6)	(17,605)	(74,737)
Total Other Financing Sources (Uses)	$ 53,907	$ (5,219)
Excess of Revenues and Other Sources Over (Under) Expenditures and Other Uses	$ (28,296)	$ (14,350)
Fund Balances - Beginning of fiscal year	157,363	171,713
Fund Balances - End of fiscal year	$ 129,067	$ 157,363

The accompanying notes are an integral part of the financial statements.

DEPARTMENT OF ENVIRONMENTAL QUALITY
Schedule of General Fund Revenues and Other Financing Sources
Fiscal Years Ended September 30
(In Thousands)

	2005	2004
REVENUES		
Taxes (Note 6)	$ 32,858	$ 1,150
Federal (Note 7)	51,556	47,796
Licensing and permits	30,678	29,360
Miscellaneous:		
Gas and oil privilege fees	5,485	4,457
Environmental pollution judgments/settlements	3,906	2,985
Solid waste facility surcharge	4,592	4,252
Other	21,402	16,832
Total Revenues	$ 150,477	$ 106,833
OTHER FINANCING SOURCES		
Transfers from other funds (Note 6)	$ 60,876	$
Total Other Financing Sources	$ 60,876	$ 0
Total Revenues and Other Financing Sources	$ 211,353	$ 106,833

The accompanying notes are an integral part of the financial schedules.

DEPARTMENT OF ENVIRONMENTAL QUALITY
Schedule of Sources and Disposition of General Fund Authorizations
Fiscal Years Ended September 30
(In Thousands)

	2005	2004
SOURCES OF AUTHORIZATIONS (Note 3)		
General purpose appropriations	$ 26,127	$ 53,581
Balances carried forward	93,554	107,231
Restricted financing sources (Notes 4 and 6)	218,974	113,017
Less: Intrafund expenditure reimbursements	(12,030)	(11,172)
Total	$ 326,625	$ 262,658
DISPOSITION OF AUTHORIZATIONS (Note 3)		
Gross expenditures and transfers out (Note 4)	$ 178,928	$ 178,321
Less: Intrafund expenditure reimbursements	(12,030)	(11,172)
Net expenditures and transfers out	$ 166,898	$ 167,149
Balances carried forward:		
Encumbrances	$ 93	$ 1,839
Restricted revenues - not authorized/used (Note 6)	154,543	86,715
Revolving loan programs	5,000	5,000
Total balances carried forward	$ 159,636	$ 93,554
Balances lapsed (Note 4)	$ 91	$ 1,954
Total	$ 326,625	$ 262,658

The accompanying notes are an integral part of the financial schedules.

Note 1 Significant Accounting Policies

a. Reporting Entity - Financial Statements

The accompanying financial statements report the financial position and the changes in financial position of the following funds administered by the Department of Environmental Quality (DEQ) as of and for the fiscal years ended September 30, 2005 and September 30, 2004:

Special Revenue Funds

Combined Environmental Protection Bond Fund (includes the Environmental Protection Bond Fund, the Clean Michigan Initiative Bond Fund, and the Great Lakes Water Quality Bond Fund)

Michigan Underground Storage Tank Financial Assurance Fund

Bottle Deposits Fund

Agency Fund

Environmental Quality Deposits Fund

These funds principally account for DEQ's environmental cleanup and grant and loan program activity. They are a part of the State of Michigan's reporting entity and are reported on in the *State of Michigan Comprehensive Annual Financial Report* (*SOMCAFR*).

b. Reporting Entity - Financial Schedules

The accompanying financial schedules report the results of DEQ's General Fund governmental operations for the fiscal years ended September 30, 2005 and September 30, 2004, which are part of the State of Michigan reporting entity and are reported on in the *SOMCAFR*.

c. Measurement Focus and Basis of Accounting

The special revenue fund financial statements and the General Fund financial schedules contained in this report are presented using the current financial resources measurement focus and the modified accrual basis of accounting as provided by generally accepted accounting

principles applicable to governments. Under the modified accrual basis of accounting, revenues are recognized as they become susceptible to accrual, generally when they are both measurable and available. Revenues are considered to be available when they are collected within the current period or soon enough thereafter to pay liabilities of the current period. Expenditures generally are recorded when a liability is incurred; however, certain expenditures related to long-term obligations are recorded only when payment is due and payable. The agency fund financial statement contained in this report is presented using the economic resources measurement focus and the accrual basis of accounting as provided by generally accepted accounting principles applicable to governments. Under the accrual basis of accounting, revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of cash flows.

d. Basis of Presentation

The accompanying financial statements present only the funds listed in Note 1a. The accompanying financial schedules present only the revenues and other financing sources and the sources and disposition of authorizations for DEQ's General Fund accounts. The *SOMCAFR* provides more extensive disclosures regarding the State's significant accounting policies; budgeting, budgetary control, and legal compliance; common cash; pension benefits and other postemployment benefits; and interfund receivables and payables.

Accordingly, these financial statements and financial schedules do not purport to, and do not, present fairly the financial position and changes in financial position or constitute a complete financial presentation of DEQ, the State of Michigan, the State's General Fund, or the State's special revenue and agency funds in conformity with generally accepted accounting principles.

The financial transactions of DEQ are recorded in the General Fund and individual funds in the State's central accounting system. The various

environmental quality funds are combined in the *SOMCAFR* into fund types described as follows:

Governmental Fund Types

Special Revenue Funds: This fund group includes operating fund activities financed by specific revenue sources that are legally restricted for specified purposes.

Fiduciary Fund Types

Agency Funds: This group includes assets held by DEQ on behalf of outside parties. DEQ's responsibility is custodial in nature, and the asset and liability balances, but not operating results, are included within these statements.

Note 2 Combined Balance Sheet Reserves for Budgetary Carry-Forwards

The elements of the reserves for budgetary carry-forwards are defined as follows:

a. Encumbrances: Authorizations carried forward to finance payments for goods or services ordered in the old fiscal year but not received by fiscal year-end. These authorizations are generally limited to obligations funded by general purpose appropriations.

b. Restricted revenues: Revenues that, by statute, are restricted for use to a particular program or activity. Generally, the expenditure of the restricted revenues is subject to annual legislative appropriation. However, the restricted revenues may also be used in subsequent years to finance expenditures for multi-year appropriations ($23,799,126 and $44,090,369 in fiscal years 2004-05 and 2003-04, respectively) and encumbrances carried forward ($15,652,379 and $19,981,815 in fiscal years 2004-05 and 2003-04, respectively).

c. Multi-year projects: Authorizations carried forward to finance work projects approved by the Legislature. These authorizations are limited to work projects funded by general purpose authorizations.

Note 3 Schedule of Sources and Disposition of General Fund Authorizations

The various elements of the schedule of sources and disposition of General Fund authorizations are defined as follows:

a. General purpose appropriations: Original appropriations and any supplemental appropriations that are financed by General Fund/general purpose revenues.

b. Balances carried forward: Authorizations for multi-year projects, encumbrances, restricted revenues - authorized, and restricted revenues - not authorized/used that were not spent as of the end of the prior fiscal year. These authorizations are available for expenditure in the current fiscal year for the purpose of the carry-forward without additional legislative authorization, except for the restricted revenues - not authorized/used.

c. Restricted financing sources: Collections of restricted revenues, restricted transfers, and restricted intrafund expenditure reimbursements to finance programs as detailed in the appropriations act. These financing sources are authorized for expenditure up to the amount appropriated. Depending upon program statute, any amounts received in excess of the appropriation are, at year-end, either converted to general purpose financing sources and made available for general appropriation in the next fiscal year or carried forward to the next fiscal year as either restricted revenues - authorized or restricted revenues - not authorized/used.

d. Intrafund expenditure reimbursements: Funding from other General Fund departments to finance a program or a portion of a program that is the responsibility of the receiving department.

e. Encumbrances: Authorizations carried forward to finance payments for goods or services ordered in the old fiscal year but not received by fiscal year-end. These authorizations are generally limited to obligations funded by general purpose appropriations.

f. Restricted revenues - not authorized/used: Revenues that, by statute, are restricted for use to a particular program or activity. Generally, the expenditure of the restricted revenues is subject to annual legislative

appropriation. However, the restricted revenues may also be used in subsequent years to finance expenditures for multi-year environmental cleanup appropriations ($10,099,022 and $27,476,223 in fiscal years 2004-05 and 2003-04, respectively) and encumbrances carried forward ($14,223,873 and $5,818,515 in fiscal years 2004-05 and 2003-04, respectively).

g. Balances lapsed: Authorizations that were unexpended and unobligated at the end of the fiscal year. These amounts are available for legislative appropriation in the subsequent fiscal year.

Note 4 Payroll and Fringe Benefit Accrual

In fiscal year 2003-04, the Office of Financial Management, Department of Management and Budget (DMB), changed its method of computing and recording accrued payroll and fringe benefit expenditures. In the *SOMCAFR,* the expenditures are not reported at the agency level; instead, they are presented at the Statewide level. The Office of Financial Management has issued a waiver which allows departments to report these transactions in their financial schedules for the fiscal year ended September 30, 2004. Reporting these transactions at the department level resulted in an increase to DEQ's restricted financing sources of $280,066, an increase to expenditures and transfers out of $499,758, and a decrease to balances lapsed of $219,692. In fiscal year 2004-05, accrued payroll and fringe benefits were recorded by DEQ.

Note 5 Joint Venture

The State, represented by DEQ, is a participant in a joint venture known as the Great Lakes Protection Fund. The joint venture is not reflected within this report because it did not meet generally accepted accounting principles' criteria for inclusion.

The Great Lakes Protection Fund is a not-for-profit corporation located in Evanston, Illinois. Its purpose is to finance and support research with respect to water quality of the Great Lakes. The eight states bordering on the Great Lakes are eligible to become members if they make a required contribution to the endowment of the Fund. Contribution requirements were established based upon water consumption and usage. Michigan is the largest contributor to the Fund, having made a contribution of $25 million, constituting approximately 30% of the total. Michigan made its required contribution in

fiscal year 1989-90 by issuing the Fund a general obligation bond authorized as part of the State's environmental protection bond program. No additional contributions from Michigan will be required.

Each of the participating seven member states is represented by two members on the Fund's Board of Directors. The Board members are selected by the states' respective governors. The Fund's financing and budgeting operations are controlled by the directors within requirements established by the Articles of Incorporation. Net earnings after operating expenses are divided into parts. One-third of the net earnings on total contributions are granted to the respective states in proportion to their contributions to the Fund, to be used for the purposes of the Fund. Two-thirds of the net earnings are available to the Fund to make other grants. The State's equity interest in the Great Lakes Protection Fund of $25 million is reflected in the *SOMCAFR* in the government-wide statement of net assets.

Complete financial statements may be obtained directly by contacting the DMB Financial Reporting Section within the Office of Financial Management at (517) 373-3029.

Note 6 MUSTFA Fund, Obligations, and Transfer

The special revenue fund named the Michigan Underground Storage Tank Financial Assurance (MUSTFA) Fund was established by Act 518, P.A. 1988, to assist certain owners and operators of underground storage tank systems in meeting their financial responsibility requirements provided for in the Solid Waste Disposal Act.

The MUSTFA Fund that is included in this report is not a full presentation of all activities related to MUSTFA. The MUSTFA program activities are recorded in the special revenue fund. Other MUSTFA obligations are recorded as long-term obligations on the government-wide statement of net assets. The MUSTFA Finance Authority (a debt service fund) was established to provide financing, including short-term and long-term debt instruments, for the MUSTFA Fund. These additional funds and statements are a part of the State of Michigan reporting entity and are reported on in the *SOMCAFR*.

Other MUSTFA financial activities are reported elsewhere as follows (in millions):

	Fiscal Year	
	2004-05	2003-04
Obligations:		
Government-wide statement of net assets:		
Bonds outstanding	$ 0.0	$ 104.8
Claims outstanding	0.0	0.0
Debt service fund:		
MUSTFA Finance Authority fund balance	(0.1)	(171.5)
Net Obligations	$ (0.1)	$ (66.7)

As the table indicates, all claims submitted under Act 518, P.A. 1988, have been settled and paid.

Pursuant to Act 390, P.A. 2004, the MUSTFA Finance Authority debt service fund financed the defeasement of principal and interest due on bonds issued by the Authority. All remaining money in the MUSTFA Fund, including redirection of the 7/8 cent environmental protection regulatory fee revenue (pursuant to Act 390, P.A. 2004), and all but approximately $91,000 of the balance from the MUSTFA Finance Authority debt service fund were transferred to the Refined Petroleum Fund (a subfund within the General Fund) during fiscal year 2004-05. The remaining balance in the MUSTFA Finance Authority debt service fund represents funds that may be needed to pay residual costs related to the defeasement.

Note 7 Federal Revenues and Expenditures

Federal revenues in the schedule of General Fund revenues and other financing sources vary from the expenditures reported in the schedule of expenditures of federal awards. The schedule of expenditures of federal awards includes payments made by the Michigan Municipal Bond Authority to subrecipients* in the State Revolving Fund and the Drinking Water State

** See glossary at end of report for definition.*

Revolving Fund. These expenditures and related federal revenues are not recorded in DEQ's accounting records.

Note 8 Funds Held as Permanent Investments

Funds held as permanent investments represent amounts that have been restricted for the purpose of providing a long-term source of investment income. These investments can include either specific investments held for the fund or portions of the fund's share of the common cash pool.

Act 153, P.A. 2006, effective May 25, 2006, transferred $22 million of these funds, determined to be surplus, from the Bottle Deposits Fund to two subfunds within the General Fund for DEQ operations.

Note 9 Contingencies and Litigation

a. K & K Construction, Inc.

K & K Construction, Inc., filed suit against DEQ in a land use/takings issue under the Wetlands Management Act. The original court decision was against DEQ for $3.7 million plus interest. However, the Michigan Supreme Court vacated the judgment and remanded for redetermination of whether a taking occurred. In July 2005, the Michigan Court of Appeals unanimously reversed the trial court judgment against DEQ and entered a judgment in DEQ's favor. This decision was appealed for a second time to the Michigan Supreme Court and, on May 17, 2006, the Michigan Supreme Court denied the application for leave to appeal, leaving intact the Michigan Court of Appeals' ruling. No liability is recorded in DEQ's financial statements for this case.

b. Petroff Enterprises, LLC

Petroff Enterprises, LLC, filed suit against three State of Michigan departments (DEQ, DMB, and the Department of Human Services) in a breach of contract issue regarding the cancellation of a lease agreement. An agreement was reached in January 2006 and the State of Michigan agreed to pay Petroff $1,500,000 to settle the suit. DEQ's share of the settlement liability ($1,125,000) is not recorded in these financial statements. In accordance with State accounting policy for governmental funds, liabilities are accrued when cases are settled and the amount is due and payable.

c. Anne E. and William J. Heaphy

Anne E. and William J. Heaphy filed suit against DEQ in a land use/takings issue under the Sand Dune Protection and Management Act. On April 18, 2006, the Michigan Court of Appeals entered a judgment against DEQ for $1,740,000 plus interest and court costs. DEQ plans to appeal the court's decision. This lawsuit liability is not recorded in these financial statements. In accordance with State accounting policy for governmental funds, liabilities are accrued when cases are settled and the amount is due and payable.

Note 10 Subsequent Events

Long-Term Borrowing

In December 2005, the State issued its Great Lakes Water Quality general obligation bonds, 2003 Strategic Water Quality Initiative Fund Series (federally taxable), in the aggregated amount of $4 million. The bonds have an interest rate of 5% and will mature on October 20, 2006.

SUPPLEMENTAL
FINANCIAL STATEMENTS AND
FINANCIAL SCHEDULE

COMBINED ENVIRONMENTAL PROTECTION BOND FUND

This Fund, which is administered by the Department of Environmental Quality (DEQ), was established by Act 328, P.A. 1988, to account for the proceeds of $660 million of Environmental Protection general obligation bonds approved by Michigan voters in November 1988. The Act specifies that the proceeds of these bonds be available to clean up sites of toxic and other environmental contamination, for solid waste projects, to capitalize the State Water Pollution Control Loan Fund, and to fund Michigan's participation in a regional Great Lakes Protection Fund. Act 380, P.A. 1996, provides that interest earnings and unappropriated or lapsed solid waste project allocations be transferred to the Cleanup and Redevelopment Subfund (CRF).

Act 284, P.A. 1998, as amended, expanded this Fund to account for the proceeds of $570 million of Clean Michigan Initiative general obligation bonds approved by Michigan voters in November 1998. The Act directs that bond proceeds be used for environmental response activities at facilities, waterfront improvements, remediation of contaminated lake and river sediments, nonpoint source pollution prevention and control projects or wellhead protection projects, water quality monitoring and water resources protection and pollution control activities, and pollution prevention programs.

Act 397, P.A. 2002, expanded this Fund to account for the proceeds of $1 billion of Great Lakes Water Quality general obligation bonds approved by Michigan voters in November 2002. The Act directs that bond proceeds be used to finance sewage treatment works projects, storm water projects, and nonpoint source projects that improve the quality of the waters of the State. The Great Lakes Water Quality Bond Fund records the bond proceeds and the administrative costs of DEQ. All programmatic loan and grant payments are reported in the financial statements of the Michigan Municipal Bond Authority.

MICHIGAN UNDERGROUND STORAGE TANK FINANCIAL ASSURANCE (MUSTFA) FUND

The MUSTFA Fund was established by Act 518, P.A. 1988, to assist certain owners and operators of underground storage tank systems in meeting their financial responsibility requirements provided for in the Solid Waste Disposal Act. All claims submitted under this statute have been settled and paid.

Act 390, P.A. 2004, extended the sunset on the 7/8 cent environmental protection regulatory fee and redirected the revenue to the newly created Refined Petroleum Fund, which was established as a restricted subfund within the General Fund. The remaining fund balance from the original MUSTFA Program was transferred to the Refined Petroleum Fund during fiscal year 2004-05.

BOTTLE DEPOSITS FUND

This Fund was created by Act 384, P.A. 1996, to provide for the disposition of unredeemed bottle deposits. The Fund is jointly administered by the Department of Treasury and DEQ. The law mandates that 25% of current period collections be returned to the dealers (as defined by the Act) and the remaining 75% be distributed to fund several subfunds.

The 75% is initially deposited into the Cleanup and Redevelopment Trust Subfund (CRTF). Of the funds received annually in CRTF, 80% is allocated to the Cleanup and Redevelopment Subfund (CRF) and 10% to the Community Pollution Prevention Subfund (CPPF). The remaining 10% stays in CRTF.

Act 153, P.A. 2006, effective May 25, 2006, transferred $10 million from CPPF and $12 million from CRTF, determined to be surplus, to two subfunds within the General Fund for DEQ operations.

Act 380, P.A. 1996, moved the former Environmental Response Fund (ERF) to a subfund of CRF. The law mandates that proceeds of all cost recovery actions taken and settlements entered into (pursuant to Part 201, Act 451, P.A. 1994) by DEQ or the Attorney General, or both, shall be credited to ERF.

DEPARTMENT OF ENVIRONMENTAL QUALITY
Combining Balance Sheet
Special Revenue Funds
As of September 30
(In Thousands)

	Combined Environmental Protection Bond Fund		Michigan Underground Storage Tank Financial Assurance Fund		Bottle Deposits Fund		Totals	
	2005	2004	2005	2004	2005	2004	2005	2004
ASSETS								
Current Assets:								
Cash	$ 3	$	$	$	$ 2	$	$ 5	$ 0
Equity in common cash	58,022	54,109		1,814	99,818	125,793	157,840	181,716
Taxes, interest, and penalties receivable				6,554			0	6,554
Amounts due from component units	11	8					11	8
Amounts due from local units	900	515			338	438	1,238	953
Other current assets		8			1,019	2,717	1,019	2,725
Total Current Assets	$ 58,936	$ 54,640	$ 0	$ 8,367	$ 101,177	$ 128,948	$ 160,113	$ 191,956
Amounts due from local units					4,289	3,550	4,289	3,550
Other noncurrent assets					1,385	1,539	1,385	1,539
Total Assets	$ 58,936	$ 54,640	$ 0	$ 8,368	$ 106,851	$ 134,036	$ 165,787	$ 197,044
LIABILITIES AND FUND BALANCES								
Current Liabilities:								
Warrants outstanding	$ 371	$ 375	$	$ 3	$ 207	$ 107	$ 578	$ 485
Accounts payable and other liabilities	27,310	23,363		35	7,034	7,365	34,344	30,762
Amounts due to other funds	25	20		5,690	143	112	168	5,822
Deferred revenue				864	245	209	245	1,073
Total Current Liabilities	$ 27,707	$ 23,758	$ 0	$ 6,592	$ 7,628	$ 7,793	$ 35,335	$ 38,142
Long-Term Liabilities:								
Deferred revenue					1,385	1,539	1,385	1,539
Total Liabilities	$ 27,707	$ 23,758	$ 0	$ 6,592	$ 9,013	$ 9,331	$ 36,720	$ 39,681
Fund Balances:								
Reserves for:								
Budgetary carry-forwards:								
Encumbrances	$	$	$	$	$ 3,247	$ 2,663	$ 3,247	$ 2,663
Restricted revenues				1,253	42,655	74,370	42,655	75,624
Multi-year projects					7,997	5,770	7,997	5,770
Revolving loan programs					20,569	20,502	20,569	20,502
Funds held as permanent investments					23,369	21,400	23,369	21,400
Total Reserved	$ 0	$ 0	$ 0	$ 1,253	$ 97,838	$ 124,705	$ 97,838	$ 125,959
Unreserved	31,229	30,883		522			31,229	31,405
Total Fund Balances	$ 31,229	$ 30,883	$ 0	$ 1,775	$ 97,838	$ 124,705	$ 129,067	$ 157,363
Total Liabilities and Fund Balances	$ 58,936	$ 54,640	$ 0	$ 8,368	$ 106,851	$ 134,036	$ 165,787	$ 197,044

DEPARTMENT OF ENVIRONMENTAL QUALITY
Combining Statement of Revenues, Expenditures, and Changes in Fund Balances
Special Revenue Funds
Fiscal Years Ended September 30
(In Thousands)

	Combined Environmental Protection Bond Fund		Michigan Underground Storage Tank Financial Assurance Fund		Bottle Deposits Fund		Totals	
	2005	2004	2005	2004	2005	2004	2005	2004
REVENUES								
Taxes	$	$	$	$ 59,575	$	$	$ 0	$ 59,575
Federal					178		178	0
Interest and other miscellaneous	3,061	4,016	7	8	23,036	23,559	26,104	27,582
Total Revenues	$ 3,061	$ 4,016	$ 7	$ 59,583	$ 23,213	$ 23,559	$ 26,281	$ 87,157
EXPENDITURES								
Current:								
General government	$ 820	$	$ 124	$ 156	$	$	$ 944	$ 156
Health services	6	316					6	316
Environmental	73,380	60,804	7	1	34,148	35,012	107,536	95,816
Total Expenditures	$ 74,206	$ 61,120	$ 132	$ 157	$ 34,148	$ 35,012	$ 108,485	$ 96,289
Excess of Revenues Over (Under) Expenditures	$ (71,145)	$ (57,104)	$ (124)	$ 59,426	$ (10,935)	$ (11,454)	$ (82,204)	$ (9,131)
OTHER FINANCING SOURCES (USES)								
Proceeds from bond issues	$ 64,935	$ 54,515	$	$	$	$	$ 64,935	$ 54,515
Premium on bond issuance	6,577						6,577	0
Transfers from other funds		1		1		15,002	0	15,004
Transfers to other funds	(21)	(15,020)	(1,651)	(59,575)	(15,933)	(143)	(17,605)	(74,737)
Total Other Financing Sources (Uses)	$ 71,491	$ 39,496	$ (1,651)	$ (59,574)	$ (15,933)	$ 14,859	$ 53,907	$ (5,219)
Excess of Revenues and Other Sources Over (Under) Expenditures and Other Uses	$ 347	$ (17,608)	$ (1,775)	$ (148)	$ (26,868)	$ 3,406	$ (28,296)	$ (14,350)
Fund Balances - Beginning of fiscal year	30,883	48,490	1,775	1,923	124,705	121,300	157,363	171,713
Fund Balances - End of fiscal year	$ 31,229	$ 30,883	$ 0	$ 1,775	$ 97,838	$ 124,705	$ 129,067	$ 157,363

DEPARTMENT OF ENVIRONMENTAL QUALITY
Balance Sheet
Combined Environmental Protection Bond Fund
Fiscal Years Ended September 30
(In Thousands)

	Environmental Protection Bond Fund		Clean Michigan Initiative Bond Fund		Great Lakes Water Quality Bond Fund		Totals	
	2005	2004	2005	2004	2005	2004	2005	2004
ASSETS								
Current Assets:								
Cash	$	$	$ 3	$	$	$	$ 3	$ 0
Equity in common cash	11,927	26,224	46,103	27,894	(9)	(8)	58,022	54,109
Amounts due from component units					11	8	11	8
Amounts due from local units			900	515			900	515
Other current assets		8					0	8
Total Current Assets	$ 11,927	$ 26,232	$ 47,006	$ 28,409	$ 3	$ 0	$ 58,936	$ 54,640
Total Assets	$ 11,927	$ 26,232	$ 47,006	$ 28,409	$ 3	$ 0	$ 58,936	$ 54,640
LIABILITIES AND FUND BALANCES								
Current Liabilities:								
Warrants outstanding	$ 47	$ 170	$ 324	$ 204	$	$	$ 371	$ 375
Accounts payable and other liabilities	5,831	7,463	21,477	15,900	2		27,310	23,363
Amounts due to other funds			25	20			25	20
Total Current Liabilities	$ 5,878	$ 7,633	$ 21,826	$ 16,124	$ 3	$ 0	$ 27,707	$ 23,758
Total Liabilities	$ 5,878	$ 7,633	$ 21,826	$ 16,124	$ 3	$ 0	$ 27,707	$ 23,758
Fund Balances:								
Total Unreserved Fund Balances	6,049	18,599	25,180	12,284			31,229	30,883
Total Liabilities and Fund Balances	$ 11,927	$ 26,232	$ 47,006	$ 28,409	$ 3	$ 0	$ 58,936	$ 54,640

DEPARTMENT OF ENVIRONMENTAL QUALITY
Statement of Revenues, Expenditures, and Changes in Fund Balances
Combined Environmental Protection Bond Fund
Fiscal Years Ended September 30
(In Thousands)

	Environmental Protection Bond Fund		Clean Michigan Initiative Bond Fund		Great Lakes Water Quality Bond Fund		Totals	
	2005	2004	2005	2004	2005	2004	2005	2004
REVENUES								
Interest and other miscellaneous	$ 1,102	$ 1,399	$ 1,924	$ 2,609	$ 35	$ 8	$ 3,061	$ 4,016
Total Revenues	$ 1,102	$ 1,399	$ 1,924	$ 2,609	$ 35	$ 8	$ 3,061	$ 4,016
EXPENDITURES								
Current:								
General government	$	$	$ 820	$	$	$	$ 820	$ 0
Health services			6	316			6	316
Environmental	13,651	23,005	59,694	37,791	35	8	73,380	60,804
Total Expenditures	$ 13,651	$ 23,005	$ 60,519	$ 38,107	$ 35	$ 8	$ 74,206	$ 61,120
Excess of Revenues Over (Under) Expenditures	$ (12,549)	$ (21,606)	$ (58,595)	$ (35,498)	$ 0	$ 0	$ (71,145)	$ (57,104)
OTHER FINANCING SOURCES (USES)								
Proceeds from bond issues	$	$ 38,891	$ 64,935	$ 15,624	$	$	$ 64,935	$ 54,515
Premium on bond issuance			6,577				6,577	0
Transfers from other funds				1			0	1
Transfers to other funds			(21)	(15,020)			(21)	(15,020)
Total Other Financing Sources (Uses)	$ 0	$ 38,891	$ 71,491	$ 605	$ 0	$ 0	$ 71,491	$ 39,496
Excess of Revenues and Other Sources Over (Under) Expenditures and Other Uses	$ (12,549)	$ 17,285	$ 12,896	$ (34,892)	$ 0	$ 0	$ 347	$ (17,608)
Fund Balances - Beginning of fiscal year	18,599	1,314	12,284	47,176			30,883	48,490
Fund Balances - End of fiscal year	$ 6,049	$ 18,599	$ 25,180	$ 12,284	$ 0	$ 0	$ 31,229	$ 30,883

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ENVIRONMENTAL QUALITY DEPOSITS FUND

This Fund was reauthorized by Act 451, P.A. 1994, as amended, to account for cash bonds posted by applicants desiring licenses to operate hazardous and solid waste disposal areas. Because the Scrap Tire Regulatory Fund created by Act 451, P.A. 1994, has similar provisions, both of these activities are accounted for in this Fund. In accordance with Act 451, P.A. 1994, as amended, interest earnings up to an annual rate of 6% are credited to the applicant's account. The receipt of cash bonds and interest earnings are recorded as additions to assets and liabilities.

This Act also specifies the circumstances under which the director of the Department of Environmental Quality is authorized to use the deposits to close and maintain a facility or return the deposit upon the operator's satisfactory closure and maintenance of the facility. The use or return of deposits or interest are recorded as deductions to assets and liabilities.

DEPARTMENT OF ENVIRONMENTAL QUALITY
Statement of Changes in Assets and Liabilities
Environmental Quality Deposits Fund
Fiscal Year Ended September 30, 2005
(In Thousands)

	Balance October 1, 2004	Additions	Deductions	Balance September 30, 2005
ASSETS				
Current Assets:				
Equity in common cash	$ 2,875	$ 105	$ 205	$ 2,775
Total Assets	$ 2,875	$ 105	$ 205	$ 2,775
LIABILITIES				
Current Liabilities:				
Accounts payable and other liabilities	$ 2,875	$ 105	$ 205	$ 2,775
Total Liabilities	$ 2,875	$ 105	$ 205	$ 2,775

DEPARTMENT OF ENVIRONMENTAL QUALITY
Statement of Changes in Assets and Liabilities
Environmental Quality Deposits Fund
Fiscal Year Ended September 30, 2004
(In Thousands)

	Balance October 1, 2003	Additions	Deductions	Balance September 30, 2004
ASSETS				
Current Assets:				
Equity in common cash	$ 3,931	$ 151	$ 1,207	$ 2,875
Total Assets	$ 3,931	$ 151	$ 1,207	$ 2,875
LIABILITIES				
Current Liabilities:				
Accounts payable and other liabilities	$ 3,931	$ 151	$ 1,207	$ 2,875
Total Liabilities	$ 3,931	$ 151	$ 1,207	$ 2,875

DEPARTMENT OF ENVIRONMENTAL QUALITY
Schedule of Expenditures of Federal Awards (1)
For the Period October 1, 2003 through September 30, 2005

Federal Agency/Program	*CFDA* (2) Number	Pass-Through Identification Number	For the Fiscal Year Ended September 30, 2004 Directly Expended	Distributed to Subrecipients	Total Expended and Distributed
Financial Assistance					
U.S. Department of Commerce					
Direct Program:					
Coastal Zone Management Administration Awards	11.419		$ 1,907,839	$ 4,126,865	$ 6,034,704
Pass-Through Program:					
University of Michigan					
Sea Grant Support	11.417	NA05OAR4171067			0
Total U.S. Department of Commerce			**$ 1,907,839**	**$ 4,126,865**	**$ 6,034,704**
U.S. Department of Defense					
Direct Program:					
State Memorandum of Agreement Program for the Reimbursement of Technical Services	12.113		$ 395,225	$	$ 395,225
Total U.S. Department of Defense			**$ 395,225**	$ 0	**$ 395,225**
U.S. Department of the Interior					
Direct Programs:					
Fish and Wildlife Management Assistance	15.608		$ 90,053	$ 14,425	$ 104,478
U.S. Geological Survey - Research and Data Collection	15.808		10,874		10,874
National Cooperative Geologic Mapping Program	15.810		34,593	25,793	60,386
Total U.S. Department of the Interior			**$ 135,520**	**$ 40,218**	**$ 175,738**
U.S. Department of Justice					
Pass-Through Program:					
Michigan Department of State Police					
State Domestic Preparedness Equipment Support Program	16.007	2003-TE-TX-0202	$ 172,864	$	$ 172,864
State Domestic Preparedness Equipment Support Program	16.007	2003-MU-T3-0018	5,917		5,917
Total U.S. Department of Justice			**$ 178,781**	$ 0	**$ 178,781**
U.S. Environmental Protection Agency					
Direct Programs:					
U.S. Environmental Protection Agency Generalist (3)	66.000		$ (40,674)	$	$ (40,674)
Air Pollution Control Program Support	66.001		3,912,434		3,912,434
State Indoor Radon Grants	66.032		180,241	170,747	350,988
Surveys, Studies, Investigations, Demonstrations and Special Purpose Activities Relating to the Clean Air Act	66.034		915,718		915,718
Water Pollution Control State and Interstate Program Support	66.419		7,208,283		7,208,283
Surveys, Studies, Demonstrations and Special Purpose Grants - Section 1442 of the Safe Drinking Water Act	66.424				0
State Public Water System Supervision	66.432		4,180,398		4,180,398
Water Quality Management Planning	66.454		449,060	175,475	624,535
Capitalization Grants for Clean Water State Revolving Funds (1)	66.458		1,595,311	48,853,589	50,448,900
Nonpoint Source Implementation Grants	66.460		2,620,666	3,498,353	6,119,019
Regional Wetland Program Development Grants	66.461		104,625	252,040	356,665

This schedule continued on next page.

For the Fiscal Year Ended September 30, 2005			
Directly Expended	Distributed to Subrecipients	Total Expended and Distributed	Total Expended and Distributed for the Two-Year Period
$ 1,679,267	$ 2,871,406	$ 4,550,673	$ 10,585,377
		0	0
$ 1,679,267	**$ 2,871,406**	**$ 4,550,673**	**$ 10,585,377**
$ 522,528	$	$ 522,528	$ 917,753
$ 522,528	$ 0	**$ 522,528**	**$ 917,753**
$ 35,753	$ 22,715	$ 58,468	$ 162,946
18,024		18,024	28,898
28,214	25,402	53,616	114,002
$ 81,991	**$ 48,117**	**$ 130,108**	**$ 305,846**
$ 27,136	$	$ 27,136	$ 200,000
		0	5,917
$ 27,136	$ 0	**$ 27,136**	**$ 205,917**
$ 8,473	$	$ 8,473	$ (32,201)
3,910,056		3,910,056	7,822,490
182,228	173,772	356,000	706,988
897,973		897,973	1,813,691
8,007,989		8,007,989	15,216,272
14,000		14,000	14,000
4,631,902		4,631,902	8,812,300
140,252	272,171	412,423	1,036,958
2,031,265	31,784,837	33,816,102	84,265,002
2,688,776	4,571,782	7,260,558	13,379,577
243,793	74,651	318,444	675,109

DEPARTMENT OF ENVIRONMENTAL QUALITY
Schedule of Expenditures of Federal Awards (1)
For the Period October 1, 2003 through September 30, 2005
Continued

Federal Agency/Program	*CFDA* (2) Number	Pass-Through Identification Number	For the Fiscal Year Ended September 30, 2004: Directly Expended	Distributed to Subrecipients	Total Expended and Distributed
Water Quality Cooperative Agreements	66.463		$ 472,994	$ 199,078	$ 672,072
Wastewater Operator Training Grant Program (Technical Assistance)	66.467		58,600		58,600
Capitalization Grants for Drinking Water State Revolving Funds (1)	66.468		1,984,834	39,288,856	41,273,690
Great Lakes Program	66.469		264,286	46,985	311,271
Hardship Grants Program for Rural Communities	66.470			48,802	48,802
State Grants to Reimburse Operators of Small Water Systems for Training and Certification Costs	66.471		212,992	346,600	559,592
Beach Monitoring and Notification Program Implementation Grants	66.472		35,965	273,747	309,712
Water Protection Grants to the States	66.474		260,770		260,770
Environmental Protection - Consolidated Research	66.500		313,785		313,785
Surveys, Studies, Investigations and Special Purpose Grants	66.606		43,988		43,988
Environmental Information Exchange Network Grant Program and Related Assistance	66.608		523,400		523,400
Environmental Policy and Innovation Grants	66.611				0
Pollution Prevention Grants Program	66.708		49,984	5,500	55,484
Multi-Media Capacity Building Grants for States and Tribes	66.709		158,801		158,801
Source Reduction Assistance	66.717				0
Hazardous Waste Management State Program Support	66.801		3,522,129		3,522,129
Superfund State, Political Subdivision, and Indian Tribe Site-Specific Cooperative Agreements	66.802		2,346,058		2,346,058
State and Tribal Underground Storage Tanks Program	66.804		186,000		186,000
Leaking Underground Storage Tank Trust Fund Program	66.805		1,828,108		1,828,108
Superfund State and Indian Tribe Core Program Cooperative Agreements	66.809		596,898		596,898
State and Tribal Response Program Grants	66.817		922,465		922,465
Brownfields Assessment and Cleanup Cooperative Agreements	66.818				0
Total Direct Programs			$ 34,908,119	$ 93,159,772	$ 128,067,891
Pass-Through Programs:					
National Fish and Wildlife Foundation					
Great Lakes Program	66.469	2004-0005-008	$	$	$ 0
Great Lakes Commission					
Great Lakes Program	66.469	A995353-02	55,473		55,473
Great Lakes Program	66.469	XA975171-01			0
Total Great Lakes Program			$ 55,473	$ 0	$ 55,473
Wayne County					
Surveys, Studies, Investigations and Special Purpose Grants	66.606	XP995743-04	$ 4,449	$	$ 4,449
Inter-Tribal					
Surveys, Studies, Investigations and Special Purpose Grants	66.606	PM975229-01	13,304		13,304
Lake Michigan Air Directors Consortium					
Surveys, Studies, Investigations and Special Purpose Grants	66.606	A975226-01	10,983		10,983
Surveys, Studies, Investigations and Special Purpose Grants	66.606	XA965860-01			0
Grand Traverse Band of Ottawa and Chippewa Indians					
Surveys, Studies, Investigations and Special Purpose Grants	66.606	A975613-01	2,288		2,288
Environmental Council of the States					
Surveys, Studies, Investigations and Special Purpose Grants	66.606	X830307-01	19,669		19,669
Association of State and Interstate Water Pollution Control Administrators					
Surveys, Studies, Investigations and Special Purpose Grants	66.606	X831070-04	605		605
Total Surveys, Studies, Investigations and Special Purpose Grants			$ 51,298	$ 0	$ 51,298
Total Pass-Through Programs			$ 106,771	$ 0	$ 106,771
Total U.S. Environmental Protection Agency			**$ 35,014,890**	**$ 93,159,772**	**$ 128,174,662**

This schedule continued on next page.

For the Fiscal Year Ended September 30, 2005			
Directly Expended	Distributed to Subrecipients	Total Expended and Distributed	Total Expended and Distributed for the Two-Year Period
$ 262,593	$ (8,094)	$ 254,499	$ 926,571
58,600		58,600	117,200
6,203,956	24,930,185	31,134,141	72,407,831
365,138		365,138	676,409
	27,466	27,466	76,268
292,022	428,325	720,347	1,279,939
52,428	226,898	279,326	589,038
276,430		276,430	537,200
436,108		436,108	749,893
144,273		144,273	188,261
118,964		118,964	642,364
770		770	770
127,163	(563)	126,600	182,084
26,199		26,199	185,000
22,891		22,891	22,891
3,533,686		3,533,686	7,055,815
1,262,930		1,262,930	3,608,988
186,000		186,000	372,000
1,773,947		1,773,947	3,602,055
503,787		503,787	1,100,685
1,001,727		1,001,727	1,924,192
217,185		217,185	217,185
$ 39,623,504	$ 62,481,430	$ 102,104,934	$ 230,172,825
$ 3,861	$ 42,816	$ 46,677	$ 46,677
		0	55,473
32,000		32,000	32,000
$ 35,861	$ 42,816	$ 78,677	$ 134,150
$	$	$ 0	$ 4,449
13,761		13,761	27,065
1,689		1,689	12,672
11,025		11,025	11,025
1,486		1,486	3,774
66,257		66,257	85,926
		0	605
$ 94,218	$ 0	$ 94,218	$ 145,516
$ 130,079	$ 42,816	$ 172,895	$ 279,666
$ 39,753,583	**$ 62,524,246**	**$ 102,277,829**	**$ 230,452,491**

DEPARTMENT OF ENVIRONMENTAL QUALITY
Schedule of Expenditures of Federal Awards (1)
For the Period October 1, 2003 through September 30, 2005
Continued

Federal Agency/Program	*CFDA* (2) Number	Pass-Through Identification Number	For the Fiscal Year Ended September 30, 2004 Directly Expended	Distributed to Subrecipients	Total Expended and Distributed
Federal Emergency Management Agency					
Direct Programs:					
Public Assistance Grants	83.544		$	$	$ 0
National Dam Safety Program	83.550		95,220		95,220
Total Direct Programs			$ 95,220	$ 0	$ 95,220
Pass-Through Program:					
Michigan Department of State Police					
Community Assistance Program State Support Services Element (CAP-SSSE)	83.105	EMC-2003-GR-7009	$ 30,000	$	$ 30,000
Total Federal Emergency Management Agency			**$ 125,220**	**$ 0**	**$ 125,220**
U.S. Department of Health and Human Services					
Pass-Through Program:					
Michigan Department of Community Health					
Surveillance of Hazardous Substance Emergency Events	93.204	U61-ATU574142-01	$	$	$ 0
Total U.S. Department of Health and Human Services			**$ 0**	**$ 0**	**$ 0**
U.S. Department of Homeland Security					
Direct Programs:					
Community Assistance Program State Support Services Element (CAP-SSSE)	97.023		$	$	$ 0
Cooperating Technical Partners	97.045		45,244		45,244
Total Direct Programs			$ 45,244	$ 0	$ 45,244
Pass-Through Programs:					
Michigan Department of State Police					
State Domestic Preparedness Equipment Support Program	97.004	2003-MU-T3-0018	$	$	$ 0
State Domestic Preparedness Equipment Support Program	97.004	2004-GE-T4-0026			0
Total State Domestic Preparedness Equipment Support Program			$ 0	$ 0	$ 0
Urban Areas Security Initiative	97.008	2003-EU-T3-0011	$	$	$ 0
Urban Areas Security Initiative	97.008	2005-GR-T5-0014			0
Total Urban Areas Security Initiative			$ 0	$ 0	$ 0
Community Assistance Program State Support Services Element (CAP-SSSE)	97.023	EMC-2004-GR-7011	$ 194,809	$	$ 194,809
Map Modernization Management Support	97.070	EMC-2004-GR-7023	$	$	$ 0
Map Modernization Management Support	97.070	EMC-2005-GR-7017			0
Total Map Modernization Management Support			$ 0	$ 0	$ 0
Total Pass-Through Programs			$ 194,809	$ 0	$ 194,809
Total U.S. Department of Homeland Security			**$ 240,053**	**$ 0**	**$ 240,053**
Total Financial Assistance			$ 37,997,528	$ 97,326,855	$ 135,324,383

This schedule continued on next page.

For the Fiscal Year Ended September 30, 2005			
Directly Expended	Distributed to Subrecipients	Total Expended and Distributed	Total Expended and Distributed for the Two-Year Period
$	$	$ 0	$ 0
14,773		14,773	109,993
$ 14,773	$ 0	$ 14,773	$ 109,993
$	$	$ 0	$ 30,000
$ 14,773	**$ 0**	**$ 14,773**	**$ 139,993**
$ 4,500	$	$ 4,500	$ 4,500
$ 4,500	**$ 0**	**$ 4,500**	**$ 4,500**
$ 204,203	$	$ 204,203	$ 204,203
530,661		530,661	575,905
$ 734,864	$ 0	$ 734,864	$ 780,108
$ 282,633	$	$ 282,633	$ 282,633
4,060		4,060	4,060
$ 286,693	$ 0	$ 286,693	$ 286,693
$ 41,131	$	$ 41,131	$ 41,131
		0	0
$ 41,131	$ 0	$ 41,131	$ 41,131
$ 6,061	$	$ 6,061	$ 200,870
$ 100,000	$	$ 100,000	$ 100,000
31,692		31,692	31,692
$ 131,692	$ 0	$ 131,692	$ 131,692
$ 465,577	$ 0	$ 465,577	$ 660,386
$ 1,200,441	**$ 0**	**$ 1,200,441**	**$ 1,440,494**
$ 43,284,219	$ 65,443,769	$ 108,727,988	$ 244,052,371

DEPARTMENT OF ENVIRONMENTAL QUALITY
Schedule of Expenditures of Federal Awards (1)
For the Period October 1, 2003 through September 30, 2005
Continued

Federal Agency/Program	*CFDA* (2) Number	Pass-Through Identification Number	For the Fiscal Year Ended September 30, 2004 Directly Expended	Distributed to Subrecipients	Total Expended and Distributed
Nonfinancial Assistance					
U.S. Environmental Protection Agency					
Direct Programs:					
Air Pollution Control Program Support	66.001		$	$	$ 0
State Indoor Radon Grants	66.032		40,495		40,495
Surveys, Studies, Investigations, Demonstrations and Special Purpose Activities Relating to the Clean Air Act	66.034		403,897		403,897
Water Pollution Control State and Interstate Program Support	66.419		601,263		601,263
Environmental Protection - Consolidated Research	66.500		31,374		31,374
Surveys, Studies, Investigations and Special Purpose Grants	66.606				0
Hazardous Waste Management State Program Support	66.801		344,743		344,743
Total U.S. Environmental Protection Agency			**$ 1,421,772**	**$ 0**	**$ 1,421,772**
Total Nonfinancial Assistance			$ 1,421,772	$ 0	$ 1,421,772
Total Expenditures of Federal Awards			$ 39,419,300	$ 97,326,855	$ 136,746,155

(1) Basis of Presentation: This schedule includes the federal grant activity of the Department of Environmental Quality (DEQ) and is presented on the modified accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations.* Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the financial statements and financial schedules.

This schedule includes payments made by the Michigan Municipal Bond Authority to subrecipients in the State Revolving Fund and the Drinking Water State Revolving Fund. These expenditures and related federal revenues are not recorded in DEQ's accounting records.

(2) *CFDA* is defined as *Catalog of Federal Domestic Assistance.*

(3) The U.S. Environmental Protection Agency (EPA) Generalist grant represents funding from the EPA's share of the Oil Spill Liability Trust Fund that is being used to reimburse DEQ for cleanup at the Lakeside Pipeline site. The negative balance reported for the fiscal year ended September 30, 2004 represents a write-off of a prior year account payable.

For the Fiscal Year Ended September 30, 2005			
Directly Expended	Distributed to Subrecipients	Total Expended and Distributed	Total Expended and Distributed for the Two-Year Period
$ 7,977	$	$ 7,977	$ 7,977
42,155		42,155	82,650
346,293		346,293	750,190
569,131		569,131	1,170,394
214		214	31,588
64,469		64,469	64,469
359,864		359,864	704,607
$ 1,390,103	**$ 0**	**$ 1,390,103**	**$ 2,811,875**
$ 1,390,103	$ 0	$ 1,390,103	$ 2,811,875
$ 44,674,322	$ 65,443,769	$ 110,118,091	$ 246,864,246

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INDEPENDENT AUDITOR'S REPORTS ON INTERNAL CONTROL AND COMPLIANCE

STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
FAX (517) 334-8079

THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters

Mr. Steven E. Chester, Director
Department of Environmental Quality
Constitution Hall
Lansing, Michigan

Dear Mr. Chester:

We have audited the financial statements and financial schedules of the Department of Environmental Quality as of and for the fiscal years ended September 30, 2005 and September 30, 2004, as identified in the table of contents, and have issued our report thereon dated March 24, 2006, except for Note 8 as to which the date is May 25, 2006 and Note 9a as to which the date is May 17, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and financial schedules and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements and financial schedules being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department's financial statements and financial schedules are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement and financial schedule amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the State's management, the Legislature, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

AUDITOR GENERAL

March 24, 2006, except for Note 8 as to which the date is May 25, 2006 and Note 9a as to which the date is May 17, 2006

STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
FAX (517) 334-8079

THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on Compliance With Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133

Mr. Steven E. Chester, Director
Department of Environmental Quality
Constitution Hall
Lansing, Michigan

Dear Mr. Chester:

Compliance

We have audited the compliance of the Department of Environmental Quality with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each major federal program for the two-year period ended September 30, 2005. The Department's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each major federal program is the responsibility of the Department's management. Our responsibility is to express an opinion on the Department's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations.* Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to in the previous paragraph that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Department's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Department's compliance with those requirements.

In our opinion, the Department of Environmental Quality complied, in all material respects, with the requirements referred to in the first paragraph that are applicable to each major

federal program for the two-year period ended September 30, 2005. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as Finding 2.

Internal Control Over Compliance

The management of the Department is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. 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 a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the Department's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. The reportable conditions are described in the accompanying schedule of findings and questioned costs as Findings 1 and 2.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that neither of the reportable conditions identified in the previous paragraph is a material weakness.

This report is intended solely for the information and use of the State's management, the Legislature, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

AUDITOR GENERAL

March 24, 2006, except for Note 8 as to which the date is May 25, 2006 and Note 9a as to which the date is May 17, 2006

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SCHEDULE OF FINDINGS
AND QUESTIONED COSTS

Section I: Summary of Auditor's Results

Financial Statements and Financial Schedules

Type of auditor's report issued:	Unqualified*
Internal control* over financial reporting:	
Material weaknesses* identified?	No
Reportable conditions* identified that are not considered to be material weaknesses?	None reported
Noncompliance or other matters material to the financial statements and/or financial schedules?	No

Federal Awards

Internal control over major programs:	
Material weaknesses identified?	No
Reportable conditions identified that are not considered to be material weaknesses?	Yes
Type of auditor's report issued on compliance for major programs:	Unqualified
Any audit findings disclosed that are required to be reported in accordance with U.S. Office of Management and Budget (OMB) Circular A-133, Section 510(a)?	Yes

Identification of major programs:

CFDA Number	Name of Federal Program
11.419	Coastal Zone Management Administration Awards
66.001	Air Pollution Control Program Support
66.419	Water Pollution Control State and Interstate Program Support

** See glossary at end of report for definition.*

66.432	State Public Water System Supervision
66.458	Capitalization Grants for Clean Water State Revolving Funds
66.460	Nonpoint Source Implementation Grants
66.801	Hazardous Waste Management State Program Support
66.802	Superfund State, Political Subdivision, and Indian Tribe Site-Specific Cooperative Agreements

Dollar threshold used to distinguish between type A and type B programs: $3,000,000

Auditee qualified as a low-risk auditee*? No

Section II: Findings Related to the Financial Statements and Financial Schedules

We did not report any findings related to the financial statements and financial schedules.

** See glossary at end of report for definition.*

Section III: Findings and Questioned Costs* Related to Federal Awards

FINDING 760601

1. Suspension and Debarment

U.S. Department of Commerce	*CFDA* 11.419: Coastal Zone Management Administration Awards
Award Number: NA17OZ1126 NA17OZ2339 NA03NOS4190088 NA04NOS4190044	Award Period: 10/01/2001 - 09/30/2005 10/01/2002 - 09/30/2004 10/01/2003 - 09/30/2005 10/01/2004 - 03/31/2006
	Questioned Costs: $0

The Department of Environmental Quality (DEQ) had not established internal control in its Coastal Zone Management (CZM) Program to ensure that it did not contract with or make grant awards to parties that had been suspended or debarred.

In the event that DEQ contracted with or awarded a grant to suspended or debarred parties, DEQ would not be eligible for federal reimbursement for any payments made to those parties.

Part 35 of the federal Common Rule states that "Grantees and subgrantees must not make any award or permit any award (subgrant or contract) at any tier to any party which is debarred or suspended. . . ." DEQ did not reference the *List of Parties Excluded from Federal Procurement or Nonprocurement Programs*, issued by the U.S. General Services Administration, or obtain certification from perspective contractors or subrecipients that their organizations and principals are not suspended or debarred prior to contracting or making awards.

Our review of a sample of 19 CZM Program subrecipient contracts disclosed that none of the subrecipients were on the federal list. However, the lack of controls designed to ensure compliance with federal laws and regulations could result in future sanctions and/or disallowances.

** See glossary at end of report for definition.*

RECOMMENDATION

We recommend that DEQ establish internal control in its CZM Program to ensure that it does not contract with or make grant awards to parties that have been suspended or debarred.

FINDING 760602

2. Subrecipient Monitoring

U.S. Department of Commerce	*CFDA* 11.419: Coastal Zone Management Administration Awards
Award Number: All	Award Periods: Various
	Questioned Costs: $0

U.S. Environmental Protection Agency	*CFDA* 66.458: Capitalization Grants for Clean Water State Revolving Funds *CFDA* 66.460: Nonpoint Source Implementation Grants *CFDA* 66.468: Capitalization Grants for Drinking Water State Revolving Funds
Award Number: All	Award Periods: Various
	Questioned Costs: $0

DEQ should establish additional internal control to ensure that it complies with the pass-through entity responsibilities as established by OMB Circular A-133.

Internal control that does not ensure compliance with federal laws and regulations for subrecipient monitoring could result in sanctions, disallowances, and/or future reductions in federal awards.

OMB Circular A-133 establishes the responsibilities for State entities that provide federal funds to subrecipients that carry out federal programs. DEQ is considered a pass-through entity in these cases.

Our review of DEQ's subrecipient monitoring disclosed:

a. DEQ did not consistently inform subrecipients of *Catalog of Federal Domestic Assistance (CFDA)* titles and numbers, award names and numbers, and federal agency names. OMB Circular A-133 requires pass-through entities to

identify federal awards by informing each subrecipient of the *CFDA* title and number, award name and number, award year, and name of the federal agency and if the award is for research and development.

b. DEQ did not perform follow-up procedures when it was unable to obtain required audit reports from its subrecipients. OMB Circular A-133 requires pass-through entities to ensure that subrecipients expending $500,000 or more in federal awards during the subrecipients' fiscal year have met the audit requirements for that fiscal year. Using a variety of procedures, DEQ initially identified 76 of its subrecipients that potentially met the audit requirement for fiscal year 2003-04 and subsequently obtained 65 subrecipient audit reports for review. During our review, we verified that 27 subrecipients met the $500,000 threshold by the amounts passed through by DEQ alone. Our review further disclosed that, despite repeated attempts, DEQ was unable to obtain a copy of the A-133 audit report for 5 (18.5%) of the 27 subrecipients. However, DEQ did not make any additional attempts to obtain the audit reports after July 2005 and did not perform any other follow-up procedures with the subrecipients, such as sanctions.

c. DEQ did not issue management decisions on any of the five A-133 audit reports received from subrecipients that included audit findings. OMB Circular A-133 requires pass-through entities to issue a management decision on audit findings within six months after receipt of a subrecipient's audit report and to ensure that the subrecipient takes appropriate and timely corrective action.

RECOMMENDATION

We recommend that DEQ establish additional internal control to ensure that it complies with the pass-through entity responsibilities as established by OMB Circular A-133.

The status of the findings related to federal awards that were reported in prior Single Audits is disclosed in the summary schedule of prior audit findings.

OTHER SCHEDULES

DEPARTMENT OF ENVIRONMENTAL QUALITY
Summary Schedule of Prior Audit Findings
As of September 30, 2005

PRIOR AUDIT FINDINGS RELATED TO THE FINANCIAL STATEMENTS AND FINANCIAL SCHEDULES

There were no findings related to the financial statements and financial schedules in the prior Single Audit*.

PRIOR AUDIT FINDINGS RELATED TO FEDERAL AWARDS

Audit Findings That Have Been Fully Corrected:

Audit Period: October 1, 2001 through September 30, 2003
Finding Number: 760401
Finding Title: State Revolving Fund* (SRF) Program* Administrative Expenditures

Finding: The Department of Environmental Quality's (DEQ's) controls did not ensure that SRF Program administrative expenditures were allowable costs.

Comments: DEQ has discontinued charges to the SRF Program for private rent or building occupancy costs that had been the policy position of the former DEQ administration and is obtaining a change in its appropriation structure for these accounts.

In order to ensure that only necessary and reasonable costs are charged to the SRF Program, Revolving Loan and Operator Certification Section staff will query the accounting database for all entries recorded on the SRF Program on a monthly basis. They will review the charges to verify grant eligibility and inform the Environmental Science and Services Division budget liaison of any necessary corrections.

** See glossary at end of report for definition.*

DEPARTMENT OF ENVIRONMENTAL QUALITY

Corrective Action Plan

As of May 5, 2006

FINDINGS RELATED TO THE FINANCIAL STATEMENTS AND FINANCIAL SCHEDULES

There were no findings related to the financial statements and financial schedules for fiscal years 2003-04 and 2004-05.

FINDINGS RELATED TO FEDERAL AWARDS

Finding Number: 760601

Finding Title: Suspension and Debarment

Management Views: The Department of Environmental Quality (DEQ) agrees with this finding and recommendation.

Corrective Action: DEQ has a departmentwide work group in place responsible for coordinating the development of standards for and the resolution of grant-related issues within DEQ. This work group is in the process of developing departmentwide standard boilerplate for DEQ grant contracts, as well as procedures to obtain assurances that grant funds are not awarded to grantees (and their contractors and subgrantees) that have been suspended or debarred from federal procurement.

Anticipated Completion Date: September 30, 2007

Responsible Individuals: Karen Best, Environmental Science and Services Division (ESSD)

Karen Jurgensen, Financial and Business Services Division (FBSD)

Finding Number: 760602

Finding Title: Subrecipient Monitoring

Management Views: DEQ agrees with this finding and recommendation.

DEQ has already improved its subrecipient monitoring processes, resulting in the identification of 38 additional subrecipient Single Audit reports that were completed during the audit period. The DEQ departmentwide work group and FBSD will evaluate additional control and monitoring activities to improve the various subrecipient processes.

Corrective Action: Regarding part a., DEQ has a departmentwide work group in place with responsibility for coordinating the development of standards for and the resolution of grant-related issues within DEQ. The work group is in the process of developing standardized grant language that will include *Catalog of Federal Domestic Assistance (CFDA)* title and number, award name and number, award year, name of the federal agency, and if the award is for research and development.

Regarding parts b. and c., FBSD will implement procedures to obtain and review 100% of required Single Audit reports. FBSD and the program divisions, in consultation with DEQ's internal audit staff, will implement procedures to ensure that management decisions are issued within the required time frames.

Anticipated Completion Date: September 30, 2007

Responsible Individuals: Karen Best, ESSD
Karen Jurgensen, FBSD

GLOSSARY

CFDA	*Catalog of Federal Domestic Assistance.*
CPPF	Community Pollution Prevention Subfund.
CRF	Cleanup and Redevelopment Subfund.
CRTF	Cleanup and Redevelopment Trust Subfund.
CZM	Coastal Zone Management.
DEQ	Department of Environmental Quality.
DMB	Department of Management and Budget.
EPA	U.S. Environmental Protection Agency.
ERF	Environmental Response Fund.
ESSD	Environmental Science and Services Division.
FBSD	Financial and Business Services Division.
financial audit	An audit that is designed to provide reasonable assurance about whether the financial schedules and/or financial statements of an audited entity are fairly presented in conformity with the disclosed basis of accounting.
internal control	A process, effected by management, designed to provide reasonable assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.
low-risk auditee	As provided for in OMB Circular A-133, an auditee that may qualify for reduced federal audit coverage if it receives an

annual Single Audit and it meets other criteria related to prior audit results. In accordance with State statute, this Single Audit was conducted on a biennial basis; consequently, this auditee is not considered a low-risk auditee.

material misstatement	A misstatement in the financial schedules and/or financial statements that causes the schedules and/or statements to not present fairly the financial position or the changes in financial position or cash flows in conformity with the disclosed basis of accounting.
material noncompliance	Violations of laws and regulations that could have a direct and material effect on major federal programs or on financial schedule and/or financial statement amounts.
material weakness	A reportable condition related to the design or operation of internal control that does not reduce to a relatively low level the risk that either misstatements caused by error or fraud in amounts that would be material in relation to the financial schedules and/or financial statements or noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.
MUSTFA	Michigan Underground Storage Tank Financial Assurance.
OMB	U.S. Office of Management and Budget.
questioned cost	A cost that is questioned by the auditor because of an audit finding: (1) which resulted from a violation or possible violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the use of federal funds, including funds used to match federal funds; (2) where the costs, at the time of the audit, are not supported by adequate documentation; or

(3) where the costs incurred appear unreasonable and do not reflect the actions a prudent person would take in the circumstances.

reportable condition — A matter coming to the auditor's attention relating to a significant deficiency in the design or operation of internal control that, in the auditor's judgment, could adversely affect the entity's ability to (1) initiate, record, process, and report financial data consistent with the assertions of management in the financial schedules and/or financial statements or (2) administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Violations of State laws, regulations, contracts, and grant agreements that should be communicated to management but are not material to the financial schedules and/or financial statements may also be reported.

Single Audit — A financial audit, performed in accordance with the Single Audit Act Amendments of 1996, that is designed to meet the needs of all federal grantor agencies and other financial report users. In addition to performing the audit in accordance with the requirements of auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, a Single Audit requires the assessment of compliance with requirements that could have a direct and material effect on a major federal program and the consideration of internal control over compliance in accordance with OMB Circular A-133.

SOMCAFR — *State of Michigan Comprehensive Annual Financial Report.*

SRF Program — The federal grant program that provides capitalization grants to states for establishing revolving funds to be used for the construction of municipal wastewater treatment projects or for

the development and implementation of nonpoint source or estuary conservation management programs and plans in compliance with the Clean Water Act.

State Revolving Fund (SRF) — A fund established within the Michigan Municipal Bond Authority to provide low-interest loans to municipalities for the construction of publicly owned water pollution control facilities.

subrecipient — A nonfederal entity that expends federal awards received from another nonfederal entity to carry out a federal program.

unqualified opinion — An auditor's opinion in which the auditor states that:

a. The financial schedules and/or financial statements presenting the basic financial information of the audited agency are fairly presented in conformity with the disclosed basis of accounting; or

b. The financial schedules and/or financial statements presenting supplemental financial information are fairly stated in relation to the basic financial schedules and/or financial statements. In issuing an "in relation to" opinion, the auditor has applied auditing procedures to the supplemental financial schedules and/or financial statements to the extent necessary to form an opinion on the basic financial schedules and/or financial statements, but did not apply auditing procedures to the extent that would be necessary to express an opinion on the supplemental financial schedules and/or financial statements taken by themselves; or

c. The audited agency complied, in all material respects, with the cited requirements that are applicable to each major federal program.

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STATE OF MICHIGAN

OFFICE of the AUDITOR GENERAL