



MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT



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

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 can 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

Department of Environmental Quality

October 1, 2009 through September 30, 2011

Report Number:
761-0100-12

Released:
June 2012

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

We identified an instance of noncompliance or other matters applicable to the financial statements and/or financial schedules that is required to be reported under *Government Auditing Standards* (Finding 1).

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Federal Awards:

Auditor's Reports Issued on Compliance

We audited 12 programs (including 4 ARRA related programs) as major programs and identified known questioned costs of \$18,987. DEQ expended a total of \$397.5 million in federal awards, including \$215.8 million of ARRA funding, during the two-year period ended September 30, 2011. We issued 11 unqualified opinions and 1 qualified opinion. The opinions issued by major program are identified on the back of this summary.

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Internal Control Over Major Programs

We identified a material weakness in internal control over federal program compliance (Finding 3). We also identified significant deficiencies in internal control over federal program compliance (Findings 2 and 4 through 10). In addition, we identified five recommendations repeated from our prior report for the two-year period ended September 30, 2009 (Findings 2, 3, and 6 through 8).

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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 (Findings 2 through 10).

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Internal Accounting and Administrative Control System:

Section 18.1489 of the *Michigan Compiled Laws* requires the Auditor General to evaluate the implementation of Sections 18.1483 - 18.1488 of the *Michigan Compiled Laws* and report to the Legislature in the financial audit of each department. As a result of Executive Reorganization Order No. 2007-31 (Consolidating Internal Audit Functions), in which responsibility for most of the sections was moved to the Office of Internal Audit Services, State Budget Office, we have evaluated the implementation of only Section 18.1485 in this financial audit.

Section 18.1485 requires each department director to establish an internal accounting and administrative control system, defines the elements of that system, defines the duties of the department director, and provides for certain reports. We determined that DEQ was in substantial compliance with Section 18.1485 of the *Michigan Compiled Laws*.

The remaining sections (Sections 18.1483, 18.1484, and 18.1486 - 18.1488 of the *Michigan Compiled Laws*) will be evaluated and reported on in the performance audit of the Office of Internal Audit Services, State Budget Office.

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We audited the following programs as major programs:

<u>CFDA Number</u>	<u>Program Title</u>	<u>Compliance Opinion</u>
11.419	Coastal Zone Management Administration Awards	Unqualified
66.001	Air Pollution Control Program Support	Qualified
66.040	<u>State Clean Diesel Grant Program</u> <ul style="list-style-type: none"> • State Clean Diesel Grant Program • ARRA - State Clean Diesel Grant Program 	Unqualified
66.432	State Public Water System Supervision	Unqualified
66.458	<u>Capitalization Grants for Clean Water State Revolving Funds</u> <ul style="list-style-type: none"> • Capitalization Grants for Clean Water State Revolving Funds • ARRA - Capitalization Grants for Clean Water State Revolving Funds 	Unqualified
66.460	Nonpoint Source Implementation Grants	Unqualified
66.468	<u>Capitalization Grants for Drinking Water State Revolving Funds</u> <ul style="list-style-type: none"> • Capitalization Grants for Drinking Water State Revolving Funds • ARRA - Capitalization Grants for Drinking Water State Revolving Funds 	Unqualified
66.469	Great Lakes Program	Unqualified
66.605	Performance Partnership Grants	Unqualified
66.802	Superfund State, Political Subdivision, and Indian Tribe Site-Specific Cooperative Agreements	Unqualified
66.805	<u>Leaking Underground Storage Tank Trust Fund Corrective Action Program</u> <ul style="list-style-type: none"> • Leaking Underground Storage Tank Trust Fund Corrective Action Program • ARRA - Leaking Underground Storage Tank Trust Fund Corrective Action Program 	Unqualified
97.091	Homeland Security Biowatch Program	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>



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

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



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

June 26, 2012

Mr. Dan Wyant, Director
Department of Environmental Quality
Constitution Hall
Lansing, Michigan

Dear Mr. Wyant:

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, 2009 through September 30, 2011.

This report contains our report summary; our independent auditor's reports on the financial statements and financial schedules; and the DEQ financial statements, financial schedules, and supplemental financial statements and 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 that could have a direct and material effect on 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 II and 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 plan to comply with the audit recommendations and submit it within 60 days after release of the audit report to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

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

Sincerely,


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

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



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

Independent Auditor's Report on the Financial Statements

Mr. Dan Wyant, Director
Department of Environmental Quality
Constitution Hall
Lansing, Michigan

Dear Mr. Wyant:

We have audited the accompanying financial statements of the Department of Environmental Quality as of and for the fiscal years ended September 30, 2011 and September 30, 2010, 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, 2011 and September 30, 2010 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, 2011 and September 30, 2010 and the changes in financial position of the special revenue fund for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the financial statements and financial schedules, the State implemented Governmental Accounting Standards Board Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 6, 2012 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 Non-Profit 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.

Sincerely,



Thomas H. McTavish, C.P.A.
Auditor General
June 6, 2012



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

Independent Auditor's Report on the Financial Schedules

Mr. Dan Wyant, Director
Department of Environmental Quality
Constitution Hall
Lansing, Michigan

Dear Mr. Wyant:

We have audited the accompanying financial schedules of the Department of Environmental Quality for the fiscal years ended September 30, 2011 and September 30, 2010, 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.

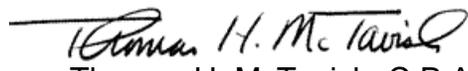
In our opinion, the financial schedules referred to in the first paragraph present fairly, in all material respects, the revenues and other financing sources and the sources and disposition of authorizations of the Department of Environmental Quality for the fiscal years ended September 30, 2011 and September 30, 2010 on the basis of accounting described in Note 1.

As discussed in Note 2 to the financial statements and financial schedules, the State implemented Governmental Accounting Standards Board Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 6, 2012 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 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.

Sincerely,


Thomas H. McTavish, C.P.A.
Auditor General
June 6, 2012

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

	<u>Special Revenue Fund</u>	
	<u>Bottle Deposits Fund</u>	
	2010	
	2011	(Restated - Note 2)
ASSETS		
Current assets:		
Cash	\$	\$ 1
Equity in common cash (Note 5)	65,620	62,014
Amounts due from local units	1,074	954
Other current assets	364	577
Total current assets	<u>\$ 67,058</u>	<u>\$ 63,545</u>
Amounts due from local units	15,346	17,662
Other noncurrent assets	1,198	1,384
Total assets	<u><u>\$ 83,602</u></u>	<u><u>\$ 82,591</u></u>
LIABILITIES AND FUND BALANCES		
Current liabilities:		
Warrants outstanding	\$ 139	\$ 137
Accounts payable and other liabilities	587	1,004
Amounts due to other funds	87	85
Deferred revenue	144	356
Total current liabilities	<u>\$ 957</u>	<u>\$ 1,582</u>
Deferred revenue	1,198	1,384
Total liabilities	<u>\$ 2,155</u>	<u>\$ 2,967</u>
Fund balances (Notes 2 and 3):		
Nonspendable fund balance	\$ 2,294	\$ 1,834
Restricted fund balance	79,153	77,790
Total fund balances	<u>\$ 81,447</u>	<u>\$ 79,625</u>
Total liabilities and fund balances	<u><u>\$ 83,602</u></u>	<u><u>\$ 82,591</u></u>

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

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

	<u>Special Revenue Fund</u>	
	<u>Bottle Deposits Fund</u>	
	<u>2011</u>	<u>2010</u>
REVENUES		
Federal	\$ 352	\$ 284
Miscellaneous	19,076	17,118
Total revenues	<u>\$ 19,428</u>	<u>\$ 17,402</u>
EXPENDITURES		
Current:		
Environmental	\$ 15,051	\$ 17,496
Total expenditures	<u>\$ 15,051</u>	<u>\$ 17,496</u>
Excess of revenues over (under) expenditures	<u>\$ 4,376</u>	<u>\$ (94)</u>
OTHER FINANCING SOURCES (USES)		
Transfers to other funds	\$ (2,554)	\$ (10,323)
Total other financing sources (uses)	<u>\$ (2,554)</u>	<u>\$ (10,323)</u>
Excess of revenues and other sources over (under) expenditures and other uses	\$ 1,823	\$ (10,417)
Fund balances - Beginning of fiscal year	<u>79,625</u>	<u>90,042</u>
Fund balances - End of fiscal year	<u>\$ 81,447</u>	<u>\$ 79,625</u>

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

DEPARTMENT OF ENVIRONMENTAL QUALITY
Statement of Fiduciary Net Assets
As of September 30
(In Thousands)

	Agency Fund	
	Environmental Quality	
	Deposits Fund	
	2011	2010
ASSETS		
Current assets:		
Equity in common cash (Note 5)	\$ 2,712	\$ 2,737
Total assets	\$ 2,712	\$ 2,737
LIABILITIES AND FUND BALANCES		
Current liabilities:		
Accounts payable and other liabilities	\$ 2,712	\$ 2,737
Total liabilities	\$ 2,712	\$ 2,737

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

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

	2011	2010 (Restated - Note 2)
REVENUES		
Taxes	\$ 32,939	\$ 33,254
From federal agencies (Note 8)	54,202	51,256
From licenses and permits	26,148	26,775
Miscellaneous	28,758	27,168
Total revenues	\$ 142,046	\$ 138,454
OTHER FINANCING SOURCES		
Proceeds from bonds and bond anticipation notes (Note 9)	\$ 20,309	\$
Transfers from other funds	2,100	8,383
Capital lease acquisitions	510	
Total other financing sources	\$ 22,919	\$ 8,383
Total revenues and other financing sources	\$ 164,965	\$ 146,837

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

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

	<u>2011</u>	<u>2010</u> (Restated - Note 2)
SOURCES OF AUTHORIZATIONS (Note 6)		
General purpose appropriations	\$ 24,347	\$ 26,650
Balances carried forward	99,380	131,034
Restricted financing sources (Note 4)	176,346	150,248
Less: Intrafund expenditure reimbursements	<u>(3,938)</u>	<u>(3,433)</u>
Total	<u>\$ 296,135</u>	<u>\$ 304,499</u>
DISPOSITION OF AUTHORIZATIONS (Note 6)		
Gross expenditures and transfers out	\$ 190,479	\$ 208,544
Less: Intrafund expenditure reimbursements	<u>(3,938)</u>	<u>(3,433)</u>
Net expenditures and transfers out	<u>\$ 186,542</u>	<u>\$ 205,111</u>
Balances carried forward:		
Encumbrances	\$ 24	\$ 6
Restricted revenues - not authorized or used	109,556	99,374
Total balances carried forward	<u>\$ 109,580</u>	<u>\$ 99,380</u>
Balances lapsed	<u>\$ 13</u>	<u>\$ 8</u>
Total	<u>\$ 296,135</u>	<u>\$ 304,499</u>

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

Notes to the Financial Statements and Financial Schedules

Note 1 Significant Accounting Policies

a. Reporting Entity

Executive Order No. 2009-45 created the Department of Natural Resources and Environment (DNRE), effective January 17, 2010. It transferred all of the authority, powers, duties, functions, responsibilities, records, personnel, property, equipment, and budgetary resources of the Department of Natural Resources (DNR) and the Department of Environmental Quality (DEQ) to DNRE by a Type II transfer and abolished DNR and DEQ.

Executive Order No. 2011-1 abolished DNRE and re-created DNR and DEQ as separate principal departments in the executive branch, effective March 13, 2011. The powers, duties, functions, responsibilities, personnel, equipment, and unexpended appropriations of DNRE were transferred back to DNR and DEQ. Executive Order No. 2009-45 was implemented for financial reporting purposes on October 1, 2010. Executive Order No. 2011-1 was implemented for financial reporting purposes on April 1, 2011. All underlying accounting transactions that posted to DNRE were moved to either DNR or DEQ prior to September 30, 2011; therefore, the executive orders have no impact on the financial statements and schedules.

b. Reporting Entity - Financial Statements

The accompanying financial statements report the financial position and the changes in financial position of the following funds administered by DEQ as of and for the fiscal years ended September 30, 2011 and September 30, 2010:

(1) Special Revenue Fund

Bottle Deposits Fund - Section 445.573c of the *Michigan Compiled Laws* created the Bottle Deposits Fund to provide for the disposition of unredeemed bottle deposits. The Department of Treasury and

DEQ jointly administer the Fund. The law mandates that an annual distribution of the funds be made as follows: 25% returned to the dealers and 75% to fund several sub-funds.

The 75% distribution to DEQ is initially deposited into the Cleanup and Redevelopment Trust Sub-Fund (CRTF) and, if not further distributed, remains there until the principal amount reaches \$200 million. Of funds received annually by the CRTF, 80% is allocated to the Cleanup and Redevelopment Sub-Fund (CRF) and 10% to the Community Pollution Prevention Sub-Fund.

Section 324.20108 of the *Michigan Compiled Laws* moved the former Environmental Response Fund (ERF) to a sub-fund of the CRF. The law mandates that proceeds of all cost recovery actions taken and settlements entered into pursuant to the ERF (excluding natural resource damages) by DEQ or the Attorney General, or both, shall be credited to the ERF.

Several DEQ sub-funds are administratively housed within the Bottle Deposits Fund, although they receive no bottle deposits revenue. Included is the State Sites Cleanup Sub-Fund, established in accordance with Section 324.20108c of the *Michigan Compiled Laws* to provide for response activities at facilities where the State is liable as an owner or operator. The following loan programs administered by DEQ are also included: the Brownfield Revolving Loan Fund created by Section 324.19608a of the *Michigan Compiled Laws*, the Revitalization Revolving Loan Fund created by Section 324.20108a of the *Michigan Compiled Laws*, and the Federal Brownfield Cleanup and Revolving Loan Fund.

(2) Agency Fund

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 at the rate of interest accrued on the State's common cash pool, not to exceed 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 DEQ director 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 and interest are recorded as deductions to assets and liabilities.

These funds 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)*.

c. Reporting Entity - Financial Schedules

The accompanying financial schedules report the results of DEQ's General Fund financial transactions for the fiscal years ended September 30, 2011 and September 30, 2010. The financial transactions of DEQ are accounted for principally in the State's General Fund and are reported on in the *SOMCAFR*.

d. Measurement Focus, Basis of Accounting, and Presentation

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 accounting principles generally accepted in the United States of America (GAAP). 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 statements contained in this report are reported using the accrual basis of accounting as provided by GAAP. Under the accrual basis of accounting, additions to and deductions from the agency fund are recorded when incurred, regardless of the timing of cash flows.

The accompanying financial statements present only the funds listed in Note 1b. 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; bonded debt; debt service and defeased debt; pension benefits; 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 GAAP.

The financial transactions of DEQ are recorded in the General Fund and in individual funds in the State's central accounting system. The Bottle Deposits Fund, a special revenue fund, and the Environmental Quality Deposits Fund, an agency fund, are included in the *SOMCAFR* in the fund types described as follows:

Governmental Fund Types:

Special Revenue Funds - This fund group accounts for specific revenue sources that are restricted or committed to expenditure for specified purposes other than debt service or capital projects.

Fiduciary Fund Types:

Agency Funds - This fund group reports assets and liabilities for deposits and investments entrusted to the State as an agent for others.

Fund Balance Classifications

In the financial statements, governmental funds report fund balance classifications that comprise a hierarchy based primarily on the extent to which the State is bound to honor constraints on the specific purposes for which amounts in those funds can be spent.

Nonspendable fund balance includes amounts that cannot be spent because they are either not in spendable form, such as inventories, prepaids, and long-term receivables, or legally or contractually required to be maintained intact.

Restricted fund balance includes amounts that are restricted when constraints placed on the use of the resources are either externally imposed by creditors, grantors, contributors, or laws or regulations of other governments or imposed by law through constitutional provisions or enabling legislation.

Note 2 Accounting Changes and Restatements

During fiscal year 2010-11, the State implemented Governmental Accounting Standards Board (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* (GASB 54). The financial statements and schedules in this report have been restated to retroactively implement GASB 54 for fiscal year 2009-10. DEQ requested and was granted approval from the Office of Financial Management within the State Budget Office to present the financial statements and schedules in this report differently from the *SOMCAFR* by restating fiscal year 2009-10 to comply with the reporting requirements of GASB 54.

The objective of GASB 54 is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more

consistently applied and by clarifying the existing governmental fund type definitions. This statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to honor constraints imposed upon the use of the resources reported in governmental funds. The new fund balance classifications are discussed in detail in Note 1.

GASB 54 also clarified governmental fund type definitions. As a result, the Combined Environmental Protection Bond Fund, reported in prior years as a special revenue fund, was determined to no longer meet the special revenue fund definition and is now reported in the General Fund. Therefore, the General Fund now includes restricted sub-funds to account for bond proceeds and related expenditures of these environmental protection bonds.

As a result of this fund reclassification, balances carried forward in fiscal year 2009-10 increased by \$40.1 million on the schedule of sources and disposition of General Fund authorizations and the Bottle Deposits Fund is the only special revenue fund presented.

Note 3 Nonspendable Fund Balance

The implementation of GASB 54 (Note 2) establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to honor constraints imposed upon the use of the resources reported in governmental funds. The line entitled "Nonspendable fund balance" on the balance sheet includes the following fund balances (in thousands). These amounts cannot be spent because they are corpus amounts that are legally or contractually required to be maintained intact:

	Fiscal Year	
	2010-11	2009-10
<u>Special Revenue Fund</u>		
Bottle Deposits Fund	\$2,294	\$1,834
	<hr/>	<hr/>
Total nonspendable fund balance	\$2,294	\$1,834
	<hr/> <hr/>	<hr/> <hr/>

Note 4 State Compliance

The restricted financing sources on the fiscal year 2010-11 schedule of sources and disposition of General Fund authorizations include \$8.0 million of general purpose revenues for expenditures from the Strategic Water Quality Initiatives Fund (SWQIF), a restricted sub-fund of the General Fund. The general purpose revenues were converted to State restricted revenues to fund SWQIF expenditures without a General Fund/general purpose appropriation. Subsequently, in fiscal year 2011-12, a transaction was recorded to convert restricted revenue back to General Fund/general purpose revenue.

Note 5 Equity in Common Cash

All of DEQ's deposits are managed by the State Treasurer. DEQ's deposits are included in the State of Michigan's common cash pool. "Equity in common cash" represents an interest in the State's common cash pool, which is used by many State funds as a short-term investment vehicle.

DEQ's common cash balances were as follows (in thousands):

	As of September 30			
	Special Revenue Fund		Agency Fund	
	Bottle Deposits Fund		Environmental Quality Deposits Fund	
	2011	2010	2011	2010
Equity in common cash	\$65,620	\$62,014	\$2,712	\$2,737

Governmental accounting and financial reporting standards require certain disclosures related to custodial credit risk and foreign currency risk for deposits. Custodial credit risk for deposits is the risk that, in the event of a depository financial institution failure, DEQ's deposits may not be recovered. Deposits are exposed to custodial credit risk if they are not covered by depository insurance and are uncollateralized, collateralized with securities held by the pledging financial institution, or collateralized with securities held by the pledging financial institution's trust department or agent but not in the DEQ fund's name. The State Treasurer's policy requires the following criteria to lessen the custodial credit risk: (1) all financial institutions holding the State's

money must pledge collateral equal to the amount of the account balance for all demand and time deposits to secure the State funds; (2) a bank, savings and loan association, or credit union holding State funds must be organized under the law of Michigan or federal law and maintain a principal office or branch office in the State of Michigan; and (3) no deposit in any financial organization may be in excess of 50% of the net worth of the organization.

Foreign currency risk for deposits is the risk that changes in exchange rates will adversely affect the fair value of deposits. Section 487.714 of the *Michigan Compiled Laws* requires State deposits to be held in a financial institution that maintains a principal office or branch office located in the State of Michigan. The State had no common cash deposits subject to foreign currency risk at September 30, 2011 and September 30, 2010.

Note 6 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 or 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 or used. DEQ carried forward \$33.6 million and \$31.9 million for contaminated site investigations, clean-up, and revitalization for fiscal years 2010-11 and 2009-10, respectively. Additional significant balances carried forward in fiscal year 2009-10 were \$26.0 million for the Clean Michigan Initiative Bond Sub-Fund and \$14.1 million for the Environmental Protection Bond Sub-Fund.

- c. Restricted financing sources: Collections of restricted revenues, restricted transfers, and restricted intrafund expenditure reimbursements used 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 or used. Significant restricted financing sources collected in fiscal year 2010-11 were \$14.9 million for contaminated site investigations, clean-up, and revitalization and \$10.0 million for the Strategic Water Quality Initiatives program.
- 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 during the 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 or 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 (\$69.0 million and \$73.2 million in fiscal years 2010-11 and 2009-10, respectively) and encumbrances carried forward (\$44.1 million and \$44.2 million in fiscal years 2010-11 and 2009-10, 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 7 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 GAAP's 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 the 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. Contributions to the Fund are permanently restricted and are not available for disbursement. Michigan is the largest contributor to the Fund, having made a contribution of \$25 million, constituting approximately 31% 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. One-third of the net earnings on total contributions (after operating expenses) 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 Financial Reporting Section within the Office of Financial Management, State Budget Office, Department of Technology, Management, and Budget.

Note 8 Federal Revenues and Expenditures

Federal revenues in the schedule of General Fund revenues and other financing sources differ from the expenditures reported in the schedule of

expenditures of federal awards. The schedule of expenditures of federal awards includes payments totaling \$285.0 million made by the Michigan Finance Authority, a discretely presented component unit of the State of Michigan, to subrecipients of its State Revolving Fund. The State Revolving Fund includes sub-funds for the Clean Water and Drinking Water programs. These expenditures and related federal revenues are not recorded in DEQ's accounting records. Although DEQ has administrative responsibility for the expenditures, the subrecipient loan disbursements and repayments flow through and are accounted for by the Michigan Finance Authority.

Note 9 Proceeds From Bond Issues

Article IX, Section 15 of the Michigan Constitution authorizes general obligation long-term borrowing, subject to approval by the Legislature and a majority of voters at a general election. General obligation bonds are backed by the full faith and credit of the State. DEQ-related general obligation bonds issued during fiscal year 2010-11 as reported in DEQ's General Fund were as follows:

General Obligation Bonds Issued	Amounts Issued (in millions)	Fiscal Year Maturities		Average Interest Rate Percentage
		First Year	Last Year	
Series 2010 A (1)	\$47	2013	2021	4.00%
Series 2010 B (1) (2)	89	2014	2016	2.21%
Total	<u>\$136 (3)</u>			

- (1) Section 324.95102 of the *Michigan Compiled Laws* authorized the issuance of bonds totaling \$675.0 million. As of September 30, 2011 and September 30, 2010, \$579.4 million and \$569.4 million, respectively, of such bonds had been issued, leaving remaining authorization of \$95.6 million and \$105.6 million, respectively.
- (2) During November 2002, voters approved a ballot proposal in which the State would issue \$1.0 billion in general obligation bonds to provide capital, which is then loaned to local units of government for water quality improvement projects. As of September 30, 2011 and September 30, 2010, \$155.7 million and \$145.6 million, respectively, of such bonds had been issued, leaving remaining authorization of \$844.3 million and \$854.4 million, respectively.
- (3) Proceeds of \$20 million were received by DEQ in fiscal year 2010-11 for the Great Lakes Water Quality and Clean Michigan Initiative expenditures and \$116 million of the amount issued was used to refund 16 separate general obligation bonds.

Note 10 Contingencies and Litigation

Attorney General ex rel DEQ v. Rexair, Inc.: In 1981, DEQ entered a consent decree with Rexair, Inc., to halt migration of and to remediate trichloroethylene (TCE) released at the Rexair facility. The TCE plume escaped the groundwater capture system. From 1994 - 2004, DEQ filed a series of motions for dispute resolution through the consent decree to have Rexair address the problem. In 2005, DEQ tried to withdraw this motion, but the circuit court denied the request. On March 24, 2006, the circuit court ordered a dismissal of the dispute resolution with prejudice and awarded Rexair attorney fees and costs. DEQ filed an application for leave of appeal, which was granted by the Court of Appeals on May 8, 2008. Rexair filed a leave for appeal to the Supreme Court. On October 3, 2008, the Supreme Court reversed the Court of Appeals decision and reinstated the circuit court's order. DEQ filed a motion for reconsideration with the Supreme Court, but the motion was denied on April 29, 2009. In February 2010, an evidentiary hearing was held at which Rexair was awarded \$3.8 million in attorney fees and costs. DEQ has filed an appeal. As the final outcome is still pending, a 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 11 Subsequent Event

Long-Term Borrowing

On October 19, 2011, the State issued its State of Michigan General Obligation Environmental Program and Refunding Bonds, Series 2011 A and 2011 B in the amounts of \$44.0 million and \$65.4 million, respectively, as fully registered bonds bearing interest which is payable semiannually commencing June 1, 2012. Proceeds of these issuances were used to refund General Obligation Environmental Program and Refunding Bonds, Series 2009 B in the amount of \$33.7 million; \$74.6 million was also deposited in a restricted sub-fund of the General Fund for the Clean Michigan Initiative Fund (\$15.0 million) and Great Lakes Water Quality Fund (\$59.6 million).

**SUPPLEMENTAL FINANCIAL STATEMENTS
AND SCHEDULE**

DEPARTMENT OF ENVIRONMENTAL QUALITY
 Statement of Changes in Assets and Liabilities
 Environmental Quality Deposits Fund
Fiscal Year Ended September 30, 2011
 (In Thousands)

	Balance October 1, 2010	Additions	Deductions	Balance September 30, 2011
ASSETS				
Current assets:				
Equity in common cash	\$ 2,737	\$ 14	\$ 39	\$ 2,712
Total assets	\$ 2,737	\$ 14	\$ 39	\$ 2,712
LIABILITIES				
Current liabilities:				
Accounts payable and other liabilities	\$ 2,737	\$ 13	\$ 38	\$ 2,712
Total liabilities	\$ 2,737	\$ 13	\$ 38	\$ 2,712

DEPARTMENT OF ENVIRONMENTAL QUALITY
 Statement of Changes in Assets and Liabilities
 Environmental Quality Deposits Fund
Fiscal Year Ended September 30, 2010
 (In Thousands)

	Balance October 1, 2009	Additions	Deductions	Balance September 30, 2010
ASSETS				
Current assets:				
Equity in common cash	\$ 2,789	\$ 19	\$ 72	\$ 2,737
Total assets	\$ 2,789	\$ 19	\$ 72	\$ 2,737
LIABILITIES				
Current liabilities:				
Accounts payable and other liabilities	\$ 2,789	\$ 19	\$ 72	\$ 2,737
Total liabilities	\$ 2,789	\$ 19	\$ 72	\$ 2,737

DEPARTMENT OF ENVIRONMENTAL QUALITY
Schedule of Expenditures of Federal Awards (1)
For the Period October 1, 2009 through September 30, 2011

Federal Agency/Program	CFDA (2) Number	Pass-Through Identification Number	For the Fiscal Year Ended September 30, 2010		
			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		\$ 964,587	\$ 1,110,109	\$ 2,074,696
Total U.S. Department of Commerce			\$ 964,587	\$ 1,110,109	\$ 2,074,696
U.S. Department of Defense					
Direct Program:					
State Memorandum of Agreement Program for the Reimbursement of Technical Services	12.113		\$ 1,235,640	\$	\$ 1,235,640
Estuary Habitat Restoration Program	12. W912P4-11-2-0001 (3)				0
Total U.S. Department of Defense			\$ 1,235,640	\$ 0	\$ 1,235,640
U.S. Department of the Interior					
Direct Programs:					
Fish and Wildlife Management Assistance	15.608		\$ 58,227	\$	\$ 58,227
U.S. Geological Survey - Research and Data Collection	15.808		61,000		61,000
National Geological and Geophysical Data Preservation Program	15.814		15,000		15,000
Total U.S. Department of the Interior			\$ 134,227	\$ 0	\$ 134,227
U.S. Environmental Protection Agency					
Direct Programs:					
Air Pollution Control Program Support	66.001		\$ 4,993,926	\$	\$ 4,993,926
State Indoor Radon Grants	66.032		289,191		289,191
Surveys, Studies, Research, Investigations, Demonstrations, and Special Purpose Activities Relating to the Clean Air Act	66.034		1,003,386	99,937	1,103,323
State Clean Diesel Grant Program	66.040		\$ 77,851	\$ 144	\$ 77,995
ARRA - State Clean Diesel Grant Program	66.040		72,541	1,202,139	1,274,680
Total State Clean Diesel Grant Program			\$ 150,392	\$ 1,202,283	\$ 1,352,675
Water Pollution Control State, Interstate, and Tribal Program Support	66.419		432,133	1,188	433,321
State Public Water System Supervision	66.432				0
Water Quality Management Planning	66.454		\$ 29,100	\$ 130,191	\$ 159,291
ARRA - Water Quality Management Planning	66.454		500,098	203,241	703,339
Total Water Quality Management Planning			\$ 529,198	\$ 333,432	\$ 862,630
Capitalization Grants for Clean Water State Revolving Funds (1)	66.458		\$	\$ 29,006,542	\$ 29,006,542
ARRA - Capitalization Grants for Clean Water State Revolving Funds	66.458			120,237,728	120,237,728
Total Capitalization Grants for Clean Water State Revolving Funds			\$ 0	\$ 149,244,270	\$ 149,244,270
Nonpoint Source Implementation Grants	66.460		646,071	3,219,450	3,865,521
Regional Wetland Program Development Grants	66.461		107,478	62,024	169,502
Capitalization Grants for Drinking Water State Revolving Funds (1)	66.468		\$ 3,253,217	\$ 16,146,991	\$ 19,400,208
ARRA - Capitalization Grants for Drinking Water State Revolving Funds	66.468		933,357	44,865,791	45,799,148
Total Capitalization Grants for Drinking Water State Revolving Funds			\$ 4,186,574	\$ 61,012,782	\$ 65,199,356
Great Lakes Program	66.469		723,120	201,574	924,694
State Grants to Reimburse Operators of Small Water Systems for Training and Certification Costs	66.471		443,957	87,337	531,294
Beach Monitoring and Notification Program Implementation Grants	66.472		38,437	211,807	250,244
Water Protection Grants to the States	66.474		194,995		194,995
Wetland Program Grants - State/Tribal Environmental Outcome Wetland Demonstration Program	66.479		264,935	146,920	411,855
Performance Partnership Grants	66.605		15,801,100		15,801,100
Environmental Information Exchange Network Grant Program and Related Assistance	66.608		714,964		714,964

This schedule continued on next page.

For the Fiscal Year Ended September 30, 2011			Total Expended and Distributed for the Two-Year Period
Directly Expended	Distributed to Subrecipients	Total Expended and Distributed	
\$ 1,508,141	\$ 1,032,762	\$ 2,540,903	\$ 4,615,599
\$ 1,508,141	\$ 1,032,762	\$ 2,540,903	\$ 4,615,599
\$ 1,049,875	\$	\$ 1,049,875	\$ 2,285,515
370,714		370,714	370,714
\$ 1,420,589	\$ 0	\$ 1,420,589	\$ 2,656,229
\$ 357,665	\$ 24,000	\$ 381,665	\$ 439,892
71,782		71,782	132,782
			15,000
\$ 429,447	\$ 24,000	\$ 453,447	\$ 587,674
\$ 4,468,783	\$	\$ 4,468,783	\$ 9,462,709
322,400		322,400	611,591
664,400	124,770	789,170	1,892,493
\$ 134,271	\$	\$ 134,271	\$ 212,266
2,363	416,608	418,971	1,693,651
\$ 136,634	\$ 416,608	\$ 553,242	\$ 1,905,917
56,860		56,860	490,181
4,687,700		4,687,700	4,687,700
\$ 1,292	\$ 184,749	\$ 186,041	\$ 345,332
350,919	473,747	824,666	1,528,005
\$ 352,211	\$ 658,496	\$ 1,010,707	\$ 1,873,337
\$ 1,312,485	\$ 3,613,356	\$ 4,925,841	\$ 33,932,383
	26,573,679	26,573,679	146,811,407
\$ 1,312,485	\$ 30,187,035	\$ 31,499,520	\$ 180,743,790
1,194,952	2,503,946	3,698,898	7,564,419
150,384	130,390	280,774	450,276
\$ 2,423,944	\$ 32,746,299	\$ 35,170,243	\$ 54,570,451
741,435	12,025,830	12,767,265	58,566,413
\$ 3,165,379	\$ 44,772,129	\$ 47,937,508	\$ 113,136,864
3,031,655	1,637,089	4,668,744	5,593,438
390,430	84,990	475,420	1,006,714
50,290	204,500	254,790	505,034
100,633		100,633	295,628
			411,855
10,819,900		10,819,900	26,621,000
179,521	2,500	182,021	896,985

DEPARTMENT OF ENVIRONMENTAL QUALITY
Schedule of Expenditures of Federal Awards (1)
For the Period October 1, 2009 through September 30, 2011
Continued

Federal Agency/Program	CFDA (2) Number	Pass-Through Identification Number	For the Fiscal Year Ended September 30, 2010		
			Directly Expended	Distributed to Subrecipients	Total Expended and Distributed
Pollution Prevention Grants Program	66.708		\$ 48,044	\$	\$ 48,044
Multi-Media Capacity Building Grants for States and Tribes	66.709		3,102		3,102
Hazardous Waste Management State Program Support	66.801		3,538,930		3,538,930
Superfund State, Political Subdivision, and Indian Tribe Site-Specific Cooperative Agreements	66.802		2,198,212		2,198,212
Underground Storage Tank Prevention, Detection and Compliance Program	66.804		475,049		475,049
Leaking Underground Storage Tank Trust Fund Corrective Action Program	66.805		\$ 1,525,738	\$	\$ 1,525,738
ARRA - Leaking Underground Storage Tank Trust Fund Corrective Action Program	66.805		2,975,998		2,975,998
Total Leaking Underground Storage Tank Trust Fund Corrective Action Program			\$ 4,501,736	\$ 0	\$ 4,501,736
Superfund State and Indian Tribe Core Program Cooperative Agreements	66.809		287,019		287,019
State and Tribal Response Program Grants	66.817		1,025,062		1,025,062
Brownfields Assessment and Cleanup Cooperative Agreements	66.818		143,187		143,187
Total Direct Programs			\$ 42,740,198	\$ 215,823,004	\$ 258,563,202
Pass-Through Programs:					
Grand Traverse Band of Ottawa and Chippewa Indians					
Training, Investigations, and Special Purpose Activities of Federally-Recognized Indian Tribes Consistent With the Clean Air Act (CAA), Tribal Sovereignty and the Protection and Management of Air Quality	66.038	XA965856-01	\$ 64	\$	\$ 64
Little River Band of Ottawa Indians					
Training, Investigations, and Special Purpose Activities of Federally-Recognized Indian Tribes Consistent With the Clean Air Act (CAA), Tribal Sovereignty and the Protection and Management of Air Quality	66.038	XA965859-01	634		634
Total Training, Investigations, and Special Purpose Activities of Federally-Recognized Indian Tribes Consistent with the Clean Air Act (CAA), Tribal Sovereignty and the Protection and Management of Air Quality			\$ 698	\$ 0	\$ 698
Friends of the St. Joe River Association, Inc.					
National Wetland Program Development Grants and Five-Star Restoration Training Grant	66.462	WD83481301			0
Central Michigan University					
Great Lakes Program	66.469	GL00E00612			0
Michigan Department of Community Health					
Science to Achieve Results (STAR) Fellowship Program	66.514	RD833628-01	1,379		1,379
State of Minnesota					
Performance Partnership Grants	66.605	BG985688-09	1,125		1,125
Environmental Council of the States					
Environmental Information Exchange Network Grant Program and Related Assistance	66.608	OS833457-01	14,572		14,572
Total Pass-Through Programs			\$ 17,774	\$ 0	\$ 17,774
Total U.S. Environmental Protection Agency			\$ 42,757,972	\$ 215,823,004	\$ 258,580,976

This schedule continued on next page.

For the Fiscal Year Ended September 30, 2011			Total Expended and Distributed for the Two-Year Period
Directly Expended	Distributed to Subrecipients	Total Expended and Distributed	
\$ 45,956	\$	\$ 45,956	\$ 94,000
3,562,284		3,562,284	3,102
1,555,364		1,555,364	7,101,214
1,203,945		1,203,945	3,753,576
\$ 2,178,438	\$	\$ 2,178,438	1,678,994
4,188,379		4,188,379	3,704,176
<u>6,366,817</u>	<u>0</u>	<u>6,366,817</u>	<u>7,164,377</u>
155,393		155,393	10,868,553
843,306		843,306	442,412
<u>\$ 44,817,682</u>	<u>\$ 80,722,453</u>	<u>\$ 125,540,135</u>	<u>\$ 384,103,337</u>
		\$ 0	\$ 64
<u>740</u>		<u>740</u>	<u>1,374</u>
\$ 740	\$ 0	\$ 740	\$ 1,438
24,981		24,981	24,981
29,280		29,280	29,280
		0	1,379
		0	1,125
<u>8,683</u>		<u>8,683</u>	<u>23,255</u>
<u>\$ 63,684</u>	<u>\$ 0</u>	<u>\$ 63,684</u>	<u>\$ 81,458</u>
<u>\$ 44,881,366</u>	<u>\$ 80,722,453</u>	<u>\$ 125,603,819</u>	<u>\$ 384,184,795</u>

DEPARTMENT OF ENVIRONMENTAL QUALITY
Schedule of Expenditures of Federal Awards (1)
For the Period October 1, 2009 through September 30, 2011
Continued

Federal Agency/Program	CFDA (2) Number	Pass-Through Identification Number	For the Fiscal Year Ended September 30, 2010		
			Directly Expended	Distributed to Subrecipients	Total Expended and Distributed
<u>U.S. Department of Homeland Security</u>					
Direct Programs:					
State Access to the Oil Spill Liability Trust Fund (4)	97.013		\$ 5,584	\$	\$ 5,584
Community Assistance Program State Support Services Element (CAP-SSSE)	97.023		277,207		277,207
National Dam Safety Program	97.041		111,697		111,697
Cooperating Technical Partners	97.045		294,572		294,572
Homeland Security Biowatch Program	97.091		1,543,222		1,543,222
Total U.S. Department of Homeland Security			\$ 2,232,282	\$ 0	\$ 2,232,282
Total Financial Assistance			\$ 47,324,708	\$ 216,933,113	\$ 264,257,821
<u>Nonfinancial Assistance</u>					
<u>U.S. Environmental Protection Agency</u>					
Direct Programs:					
Air Pollution Control Program Support	66.001		\$ 94,251	\$	\$ 94,251
Performance Partnership Grants	66.605		302,034		302,034
Hazardous Waste Management State Program Support	66.801		266,733		266,733
Total U.S. Environmental Protection Agency			\$ 663,018	\$ 0	\$ 663,018
Total Nonfinancial Assistance			\$ 663,018	\$ 0	\$ 663,018
Total Expenditures of Federal Awards			\$ 47,987,726	\$ 216,933,113	\$ 264,920,839

(1) Basis of Presentation: This schedule presents the federal grant activity of the Department of Environmental Quality (DEQ) on the modified accrual basis of accounting and 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. In addition, this schedule includes payments totaling \$285.0 million made by the Michigan Finance Authority to subrecipients of its State Revolving Fund. The State Revolving Fund includes sub-funds for the Clean Water and Drinking Water programs. 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) CFDA number is not available. The cooperative agreement number for the program is W912P4-11-2-0001.

(4) The State Access to the Oil Spill Liability Trust Fund grant represents funding from the Oil Spill Liability Trust Fund that is being used to reimburse DEQ for cleanup at the Michigan Petroleum Technologies, White Division site.

For the Fiscal Year Ended September 30, 2011			Total Expended and Distributed for the Two-Year Period
Directly Expended	Distributed to Subrecipients	Total Expended and Distributed	
\$	\$	\$ 0	\$ 5,584
233,741		233,741	510,948
105,674		105,674	217,371
71,023		71,023	365,595
1,515,937		1,515,937	3,059,159
\$ 1,926,375	\$ 0	\$ 1,926,375	\$ 4,158,657
\$ 50,165,918	\$ 81,779,215	\$ 131,945,133	\$ 396,202,954
\$ 97,904	\$	\$ 97,904	\$ 192,155
345,315		345,315	647,349
204,831		204,831	471,564
\$ 648,050	\$ 0	\$ 648,050	\$ 1,311,068
\$ 648,050	\$ 0	\$ 648,050	\$ 1,311,068
\$ 50,813,968	\$ 81,779,215	\$ 132,593,183	\$ 397,514,022

INDEPENDENT AUDITOR'S REPORTS ON INTERNAL CONTROL AND COMPLIANCE



STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
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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. Dan Wyant, Director
Department of Environmental Quality
Constitution Hall
Lansing, Michigan

Dear Mr. Wyant:

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, 2011 and September 30, 2010, as identified in the table of contents, and have issued our report thereon dated June 6, 2012. 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

Management of the Department is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Department's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements and financial schedules, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements and/or financial schedules will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined in the preceding paragraph.

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 an instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards* and which is described in the accompanying schedule of findings and questioned costs in Finding 1.

The Department's response to the finding identified in our audit is described in the accompanying corrective action plan. We did not audit the Department's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Governor, the Legislature, management, others within the Department, 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.

Sincerely,



Thomas H. McTavish, C.P.A.
Auditor General
June 6, 2012



STATE OF MICHIGAN
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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on Compliance With
Requirements That Could Have a Direct and Material Effect on
Each Major Program and on Internal Control Over Compliance in
Accordance With OMB Circular A-133

Mr. Dan Wyant, Director
Department of Environmental Quality
Constitution Hall
Lansing, Michigan

Dear Mr. Wyant:

Compliance

We have audited the Department of Environmental Quality's compliance with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the Department's major federal programs for the two-year period ended September 30, 2011. 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 of its major federal programs is the responsibility of the Department's management. Our responsibility is to express an opinion on the Department's compliance based on our audit.

Except as discussed in the following paragraph, 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 preceding 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.

As described in Finding 3 in the accompanying schedule of findings and questioned costs, the Department could not provide sufficient documentation supporting its compliance with Air Pollution Control Program Support regarding the matching, level of effort, and earmarking requirement nor were we able to satisfy ourselves as to the Department's compliance with that requirement by other auditing procedures.

In our opinion, except for the effects of such noncompliance, if any, as might have been determined had we been able to examine sufficient evidence regarding the Department of Environmental Quality's compliance with the requirements of Air Pollution Control Program Support regarding matching, level of effort, and earmarking described in the preceding paragraph, the Department of Environmental Quality complied, in all material respects, with the compliance requirements referred to in the first paragraph that

could have a direct and material effect on each of its major federal programs for the two-year period ended September 30, 2011. The results of our auditing procedures also disclosed other 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 in Findings 2 through 10.

Internal Control Over Compliance

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 the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be significant deficiencies or material weaknesses and, therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified a deficiency in internal control over compliance that we consider to be a material weakness and other deficiencies that we consider to be significant deficiencies.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiency in internal control over compliance described in the accompanying schedule of findings and questioned costs in Finding 3 to be a material weakness.

A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs in Findings 2 and 4 through 10 to be significant deficiencies.

The Department's responses to the findings identified in our audit are described in the accompanying corrective action plan. We did not audit the Department's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the Governor, the Legislature, management, others within the Department, 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.

Sincerely,



Thomas H. McTavish, C.P.A.

Auditor General

June 6, 2012

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
Significant deficiencies* identified that are not considered to be material weaknesses?	None reported
Noncompliance or other matters material to the financial statements and/or financial schedules?	Yes

Federal Awards

Internal control over major programs:	
Material weaknesses* identified?	Yes
Significant deficiencies* identified that are not considered to be material weaknesses?	Yes

Type of auditor's report issued on compliance for major programs:
Unqualified for all major federal programs except Air Pollution Control Program Support, which is qualified*.

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
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Identification of major programs:

<u>CFDA* Number</u>	<u>Name of Federal Program</u>
11.419	Coastal Zone Management Administration Awards
66.001	Air Pollution Control Program Support
66.040	<u>State Clean Diesel Grant Program</u> <ul style="list-style-type: none"> • State Clean Diesel Grant Program • ARRA* - State Clean Diesel Grant Program

* See glossary at end of report for definition.

66.432	State Public Water System Supervision
66.458	<u>Capitalization Grants for Clean Water State Revolving Funds</u> <ul style="list-style-type: none"> • Capitalization Grants for Clean Water State Revolving Funds • ARRA - Capitalization Grants for Clean Water State Revolving Funds
66.460	Nonpoint Source Implementation Grants
66.468	<u>Capitalization Grants for Drinking Water State Revolving Funds</u> <ul style="list-style-type: none"> • Capitalization Grants for Drinking Water State Revolving Funds • ARRA - Capitalization Grants for Drinking Water State Revolving Funds
66.469	Great Lakes Program
66.605	Performance Partnership Grants
66.802	Superfund State, Political Subdivision, and Indian Tribe Site-Specific Cooperative Agreements
66.805	<u>Leaking Underground Storage Tank Trust Fund Corrective Action Program</u> <ul style="list-style-type: none"> • Leaking Underground Storage Tank Trust Fund Corrective Action Program • ARRA - Leaking Underground Storage Tank Trust Fund Corrective Action Program
97.091	Homeland Security Biowatch Program

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

Auditee qualified as a low-risk auditee*? No

* See glossary at end of report for definition.

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

FINDING (7611201)

1. State Compliance

The Department of Environmental Quality (DEQ) and the Department of Technology, Management, and Budget (DTMB) did not comply with State law when expending General Fund/general purpose revenues for expenditures of the Strategic Water Quality Initiatives Fund (SWQIF), a restricted sub-fund of the General Fund. As a result, DEQ spent \$8.0 million of State General Fund/general purpose funds for SWQIF program expenditures without authorization from the Legislature. In addition, on its schedule of sources and disposition of General Fund authorizations for fiscal year 2010-11, DEQ overstated restricted financing sources and did not report overexpenditures of \$8.0 million.

Article IX, Section 17 of the Michigan Constitution states that no money shall be paid out of the State treasury except in pursuance of appropriations made by law. Also, Section 453, Act 431, P.A. 1984, limits the amount that can be expended from restricted resources to the amount appropriated or amounts received during the fiscal year, together with the balances carried forward from the previous fiscal year, whichever is less.

DEQ incurred program expenditures in the SWQIF during fiscal year 2010-11 in anticipation of receiving bond proceeds, which would fund the expenditures. However, DEQ did not receive the bond proceeds until fiscal year 2011-12. As a result, DEQ did not have the restricted revenue required by Act 431, P.A. 1984, to authorize the SWQIF expenditures. Instead, DTMB, on behalf of DEQ, converted \$8.0 million of General Fund/general purpose miscellaneous revenue to restricted revenue for DEQ to use. DEQ did not have a General Fund/general purpose appropriation for the SWQIF Program and, therefore, had no legislative approval to make the conversion.

After receipt of the bond proceeds in fiscal year 2011-12, DTMB recorded a transaction to convert \$8.0 million in restricted revenue back to General Fund/general purpose miscellaneous revenue.

RECOMMENDATION

We recommend that DEQ and DTMB comply with State law when expending General Fund/general purpose revenues for expenditures of the SWQIF, a restricted sub-fund of the General Fund.

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

OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, requires the auditor to test key controls at a level that would provide sufficient evidence that the established control structure would provide a high probability that material federal program noncompliance would be prevented or detected and corrected. This requires that the auditor set the tolerable exception rate of occurrence at a very low level. During the audit fieldwork, the auditor, in close consultation with the auditee, identifies the key controls that the auditee has established to ensure federal program compliance. In those cases in which the auditor's tests of key controls identify exception rates in excess of the tolerable exception rate of occurrence, the auditor must generally report the observed exception rate in the report finding.

Further, Circular A-133 requires the auditor to report in this section of the audit report known questioned costs that are greater than \$10,000 for a type of compliance requirement for a major program and known questioned costs that are less than \$10,000 for a type of compliance requirement for a major program if it is likely that total questioned costs would exceed \$10,000.

As a result of these low required reporting thresholds, the reader may note that, in some cases, the observed exception rates of occurrence and reported known questioned costs appear insignificant in relation to the overall federal expenditures of the auditee. After the audit report is filed with the federal audit clearinghouse, the responsible federal agency is required to issue a management decision within six months of the receipt of the audit report. The management decision may include a request for the return of the known questioned costs.

* See glossary at end of report for definition.

FINDING (7611202)

2. Coastal Zone Management Administration Awards, CFDA 11.419

U.S. Department of Commerce	CFDA 11.419: Coastal Zone Management Administration Awards
Award Number: NA06NOS4190250 NA07NOS4190184 NA08NOS4190465 NA09NOS4190162 NA07NOS4190241 NA10NOS4190078 NA10NOS4190081 NA10NOS4190210	Award Period: 10/01/2006 - 09/30/2009 10/01/2007 - 09/30/2010 10/01/2008 - 09/30/2011 10/01/2009 - 09/30/2012 10/01/2007 - 03/31/2011 07/01/2010 - 12/31/2011 07/01/2010 - 12/31/2011 10/01/2010 - 03/31/2012
	Known Questioned Costs: \$0

DEQ's internal control over the Coastal Zone Management Administration Awards (CZM) Program did not ensure compliance with federal laws and regulations regarding the monitoring of subrecipient* single audit* reports.

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

Federal expenditures for the CZM Program totaled \$4.6 million for the two-year period ended September 30, 2011.

OMB Circular A-133, Section 400(d) requires DEQ to ensure that subrecipients expending \$500,000 or more in federal awards meet the single audit requirements. In addition, OMB Circular A-133, Section 400(d) requires DEQ to issue a management decision on subrecipient audit findings and ensure that the subrecipient takes appropriate and timely corrective action.

Our review of DEQ's subrecipient monitoring efforts disclosed:

- a. During fiscal year 2009-10, DEQ did not receive a single audit report from one subrecipient that required a single audit report. This subrecipient was another

* See glossary at end of report for definition.

State department. DEQ developed a tracking spreadsheet based on established subrecipient coding in the accounting records to help ensure that all required single audit reports were received. However, the tracking sheet did not include subrecipients that were other State departments.

We reported a similar condition in the previous two single audits. DEQ indicated in its November 2011 corrective action plan that it would continue its effort to obtain 100% of the required audit reports and that it had established additional procedures to help determine whether an audit report is required.

- b. During fiscal year 2010-11, DEQ did not receive a single audit report or verify that an audit report was not required for all 65 subrecipients. DEQ was in the process of establishing a service level agreement with the Michigan Department of Education (MDE) for subrecipient monitoring services; however, the agreement did not take effect until October 1, 2011. Therefore, during fiscal year 2010-11, DEQ had the responsibility for obtaining and reviewing the subrecipients' single audit reports.

RECOMMENDATION

We again recommend that DEQ improve its internal control over the CZM Program to ensure compliance with federal laws and regulations regarding the monitoring of subrecipient single audit reports.

FINDING (7611203)

3. Air Pollution Control Program Support, CFDA 66.001

U.S. Environmental Protection Agency	CFDA 66.001: Air Pollution Control Program Support
Award Number: A00571107	Award Period: 10/01/2009 - 09/30/2011
	Known Questioned Costs: \$0

DEQ's internal control over Air Pollution Control Program Support did not ensure compliance with federal laws and regulations regarding matching, level of effort, and earmarking. DEQ could not provide sufficient documentation supporting its compliance with the matching, level of effort, and earmarking requirement nor were

we able to satisfy ourselves that DEQ complied with the one requirement by other auditing procedures. As a result, we issued a qualified opinion on compliance with federal laws and regulations for Air Pollution Control Program Support.

Internal control that does not ensure compliance with federal laws and regulations could result in sanctions, disallowances, and/or future reductions of Air Pollution Control Program Support awards.

Federal expenditures for Air Pollution Control Program Support totaled \$9.7 million for the two-year period ended September 30, 2011.

DEQ is required to include in its calculation of required maintenance of effort all State-funded expenditures for the core federal grant activities contained in the grant work plan and, if used to meet the minimum required match for the program, DEQ is required to include any State-funded activities that were not required by the grant work plan but that were for activities included in the spectrum of Air Pollution Control Program Support. DEQ overmatched the federal grant award; however, DEQ could not provide sufficient documentation to support how much of the match and overmatch was for core activities contained in the work plan and how much was for activities that were not required by the grant work plan. As a result, we could not determine the required maintenance of effort level for either fiscal year or if DEQ complied with the maintenance of effort requirements.

Title 40, Part 35, section 146 of the *Code of Federal Regulations** (*CFR*) requires DEQ to expend annually on recurrent activities an amount of non-federal funds at least equal to such expenditures during the preceding fiscal year. It also provides that, if the expenditure data for the preceding fiscal year shows that DEQ did not meet the requirements of federal regulation 40 *CFR* 35.146, the regional administrator will take action to recover the grant funds for the year in which the agency did not maintain its level of effort.

We reported a similar condition in our prior single audit. DEQ indicated in its November 2011 corrective action plan that it would implement an accounting solution to separately identify activities required by the grant award.

* See glossary at end of report for definition.

RECOMMENDATION

We again recommend that DEQ improve its internal control over Air Pollution Control Program Support to ensure compliance with federal laws and regulations regarding matching, level of effort, and earmarking.

FINDING (7611204)

4. State Clean Diesel Grant Program and ARRA - State Clean Diesel Grant Program, CFDA 66.040

U.S. Environmental Protection Agency	CFDA 66.040: State Clean Diesel Grant Program CFDA 66.040: ARRA - State Clean Diesel Grant Program
Award Number: 2D-00E83601	Award Period: 04/14/2009 - 09/30/2011
	Known Questioned Costs: \$0

DEQ's internal control over the State Clean Diesel Grant Program did not ensure compliance with federal laws and regulations regarding subrecipient monitoring and special tests and provisions.

Internal control that does not ensure compliance with federal laws and regulations could result in sanctions, disallowances, and/or future reductions of State Clean Diesel Grant Program awards.

Federal expenditures for the State Clean Diesel Grant Program totaled \$1.9 million for the two-year period ended September 30, 2011, including \$1.7 million in ARRA related expenditures.

Our exceptions, by compliance area, are as follows:

a. Subrecipient Monitoring

During fiscal year 2010-11, DEQ did not receive a single audit report or verify that an audit report was not required for all 5 subrecipients related to the State Clean Diesel Grant program. DEQ was in the process of establishing a service level agreement with MDE for subrecipient monitoring services; however, the agreement did not take effect until October 1, 2011.

Therefore, during fiscal year 2010-11, DEQ had the responsibility for obtaining and reviewing the subrecipients' single audit reports.

OMB Circular A-133, Section 400(d) requires DEQ to ensure that subrecipients expending \$500,000 or more in federal awards meet the single audit requirements. In addition, OMB Circular A-133, Section 400(d) requires DEQ to issue a management decision on subrecipient audit findings and ensure that the subrecipient takes appropriate and timely corrective action.

b. Special Tests and Provisions

DEQ did not have a process in place to inform the subrecipients of the requirement to include information to specifically identify ARRA funding on their data collection forms for the 5 subrecipient grant agreements funded with ARRA funds. We noted that, for 1 of these 5 subrecipients, ARRA funds were not properly identified on the data collection form as the ARRA - State Clean Diesel Grant Program.

DEQ's federal grant award terms and conditions provide that the grant award is subject to all applicable provisions of implementing guidance for ARRA issued by OMB. OMB implementing guidance requires DEQ to have its subrecipients separately identify the expenditures for federal awards under ARRA on their schedules of expenditures of federal awards (SEFAs) and data collection forms.

RECOMMENDATION

We recommend that DEQ improve its internal control over the State Clean Diesel Grant Program to ensure compliance with federal laws and regulations regarding subrecipient monitoring and special tests and provisions.

FINDING (7611205)

5. State Public Water System Supervision, CFDA 66.432

U.S. Environmental Protection Agency	CFDA 66.432: State Public Water System Supervision
Award Number: F00E00716-2	Award Period: 10/01/2010 - 09/30/2011
	Known Questioned Costs: \$2,006

DEQ's internal control over the State Public Water System Supervision (PWSS) Program did not ensure compliance with federal laws and regulations regarding activities allowed or unallowed; allowable costs/cost principles; and matching, level of effort, and earmarking. As a result, we identified known questioned costs of \$2,006.

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

The PWSS Program was included as part of the Performance Partnership Grants (PPG) Program during the first year of the audit period (October 1, 2009 through September 30, 2010) and was not separately reviewed. Federal expenditures for the PWSS Program totaled \$4.7 million for the fiscal year ended September 30, 2011.

Our exceptions, by compliance area, are as follows:

a. Activities Allowed or Unallowed

DEQ's internal control over the PWSS Program did not ensure that expenditures charged were for allowed activities. As a result, we identified known questioned costs of \$2,006. Our review disclosed that DEQ inappropriately obtained federal reimbursement for State vehicle usage without verifying that the vehicles were used for activities related to the PWSS Program. We reviewed 11 vehicle usage expenditures and related vehicle and employee time reports. DEQ could not provide sufficient documentation to support that the charges were only for employees working on PWSS Program related activities.

Attachment B, section 43 of OMB Circular A-87, *Selected Items of Cost* (federal regulation 2 CFR 225), allows travel expenses to be charged to a federal program only when they specifically relate to the federal program.

* See glossary at end of report for definition.

b. Allowable Costs/Cost Principles

DEQ's internal control did not ensure that PWSS Program expenditures met the allowable cost principles of OMB Circular A-87 (federal regulation 2 *CFR* 225). We questioned costs of \$2,006 in the Activities Allowed or Unallowed section (part a. of this finding).

As discussed in the Activities Allowed or Unallowed section (part a. of this finding), DEQ did not maintain documentation to support that State vehicle usage charged to the PWSS Program was for activities related to that Program.

Attachment A, sections C.1.b. and C.1.j. of OMB Circular A-87 (federal regulation 2 *CFR* 225) require that costs charged to federal programs be allocable to the grant and adequately documented, respectively.

c. Matching, Level of Effort, and Earmarking

DEQ's internal control did not ensure that it complied with federal laws and regulations regarding matching, level of effort, and earmarking.

As discussed in the Activities Allowed or Unallowed section (part a. of this finding) and the Allowable Costs/Cost Principles section (part b. of this finding), DEQ's State vehicle usage was charged to the PWSS Program without verification that the vehicles were used for activities related to the PWSS Program. We found that DEQ inappropriately applied the State's portion of these charges to satisfy its PWSS Program matching requirements. However, DEQ met the matching requirements for the PWSS Program through additional match expenditures.

Federal regulation 40 *CFR* 31.24 requires that costs used for matching or cost sharing be applicable to the federal award.

RECOMMENDATION

We recommend that DEQ improve its internal control over the PWSS Program to ensure compliance with federal laws and regulations regarding activities allowed or unallowed; allowable costs/cost principles; and matching, level of effort, and earmarking.

FINDING (7611206)

6. Capitalization Grants for Clean Water State Revolving Funds and ARRA - Capitalization Grants for Clean Water State Revolving Funds, CFDA 66.458

U.S. Environmental Protection Agency	CFDA 66.458: Capitalization Grants for Clean Water State Revolving Funds CFDA 66.458: ARRA - Capitalization Grants for Clean Water State Revolving Funds
Award Number: CS-260001-08 CS-260001-09 CS-260001-10 2W-00E75201	Award Period: 10/01/2007 - 09/30/2010 10/01/2008 - 09/30/2013 10/01/2009 - 09/30/2014 10/01/2008 - 12/31/2013
	Known Questioned Costs: \$0

DEQ's internal control over the Capitalization Grants for Clean Water State Revolving Funds (CWSRF) Program* did not ensure compliance with federal laws and regulations regarding reporting, subrecipient monitoring, and special tests and provisions.

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

Federal expenditures for the CWSRF Program totaled \$180.7 million for the two-year period ended September 30, 2011, including \$146.8 million in ARRA related expenditures.

Our exceptions, by compliance area, are as follows:

a. Reporting

DEQ's internal control did not ensure that its federal reports were accurate and supported by its financial records.

DEQ did not have a process in place to verify the accuracy of the information contained in the ARRA Section 1512 report. Without adequate internal

* See glossary at end of report for definition.

control, DEQ cannot ensure the completeness and accuracy of the ARRA Section 1512 report.

OMB implementing guidance for ARRA provides that prime recipients, as owners of the data submitted, have principal responsibility for the quality of the information submitted.

We reported a similar condition in our prior single audit. DEQ indicated in its November 2011 corrective action plan that it would work to improve its validation process of Section 1512 reporting elements to the extent possible. However, DEQ did not document this review.

b. Subrecipient Monitoring

DEQ's internal control over the CWSRF Program did not ensure compliance with the pass-through entity* responsibilities as established by OMB Circular A-133. Our review disclosed:

- (1) DEQ did not have a process in place to inform the subrecipients of the federal award number at the time of the subaward for the four supplemental agreements we reviewed.

OMB Circular A-133, Section 400(d) requires DEQ to inform each subrecipient of the federal award number.

- (2) During fiscal year 2010-11, DEQ did not receive a single audit report or verify that an audit report was not required for all 76 subrecipients related to the CWSRF Program. DEQ was in the process of establishing a service level agreement with MDE for subrecipient monitoring services; however, the agreement did not take effect until October 1, 2011. Therefore, during fiscal year 2010-11, DEQ had the responsibility for obtaining and reviewing the subrecipients' single audit reports.

OMB Circular A-133, Section 400(d) requires DEQ to ensure that subrecipients expending \$500,000 or more in federal awards meet the single audit requirements. In addition, OMB Circular A-133,

* See glossary at end of report for definition.

Section 400(d) requires DEQ to issue a management decision on subrecipient audit findings and ensure that the subrecipient takes appropriate and timely corrective action.

We reported a similar condition in the previous two single audits. DEQ indicated in its November 2011 corrective action plan that it would continue to make efforts to obtain 100% of the required audit reports and would establish additional procedures to help determine whether an audit report is required. However, as noted, the service level agreement did not take effect until October 1, 2011.

c. Special Tests and Provisions

DEQ's internal control did not ensure that it complied with federal laws and regulations regarding special test and provision requirements for ARRA funds. Our review disclosed:

- (1) DEQ did not have a process in place to inform the subrecipients of the federal award number at the time of subaward and did not inform the subrecipients of the federal award number and the amount of ARRA funds at the time of disbursement of funds for the 10 supplemental agreements funded with ARRA funds.

DEQ's federal grant award terms and conditions provide that the grant award is subject to all applicable provisions of implementing guidance for ARRA issued by OMB. OMB implementing guidance requires DEQ to separately identify to each subrecipient, at the time of subaward and disbursement of funds, the federal award number, the *CFDA* number, and the amount of ARRA funds.

We reported a similar condition in our prior single audit. DEQ indicated in its November 2011 corrective action plan that it modified the letters to subrecipients to include the federal award number and the amount of ARRA funds.

- (2) DEQ did not have a process in place to inform the subrecipients of the requirement to include information to specifically identify ARRA funding

on their data collection forms in the 10 supplemental agreements reviewed or the 25 notification of disbursement letters sent to subrecipients.

DEQ's federal grant award terms and conditions provide that the grant award is subject to all applicable provisions of implementing guidance for ARRA issued by OMB. OMB implementing guidance requires DEQ to have its subrecipients separately identify the expenditures for federal awards under ARRA on their SEFAs and data collection forms.

We reported a similar condition in our prior single audit. DEQ indicated in its November 2011 corrective action plan that it modified the letters to subrecipients to include the requirement to specifically identify ARRA funding on the SEFAs and data collection forms.

RECOMMENDATION

We again recommend that DEQ improve its internal control over the CWSRF Program to ensure compliance with federal laws and regulations regarding reporting, subrecipient monitoring, and special tests and provisions.

FINDING (7611207)

7. Nonpoint Source Implementation Grants, CFDA 66.460

U.S. Environmental Protection Agency	CFDA 66.460: Nonpoint Source Implementation Grants
Award Number:	Award Period:
C9975474-06	10/01/2005 - 03/31/2011
C9975474-07	10/01/2006 - 09/30/2011
C9975474-08	10/01/2007 - 09/30/2012
C9975474-09	10/01/2008 - 09/30/2013
C9975474-10	10/01/2009 - 09/30/2014
C9975474-11	10/01/2010 - 09/30/2015
I00E00357	06/01/2010 - 09/30/2012
	Known Questioned Costs: \$0

DEQ's internal control over the Nonpoint Source Implementation Grants (NPS) Program did not ensure compliance with federal laws and regulations regarding matching, level of effort, and earmarking and subrecipient monitoring.

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

Federal expenditures for the NPS Program totaled \$7.6 million for the two-year period ended September 30, 2011.

Our exceptions, by compliance area, are as follows:

a. Matching, Level of Effort, and Earmarking

DEQ's internal control did not ensure compliance with federal laws and regulations regarding matching. Our review disclosed that DEQ did not consistently require subrecipients to submit supporting documentation of matching expenditures used to satisfy the NPS Program match requirements. However, the existence of additional match identified by DEQ allowed DEQ to meet the matching requirements in total for the two closed grants we reviewed. Therefore, we did not question the costs of the related federal expenditures.

Our review disclosed that DEQ did not obtain invoices, receipts, or other detailed documentation to adequately support matching expenditures reported in 2 (8%) of 25 subrecipient financial reports. We also noted that for 2 (29%) of 7 subrecipient financial reports, DEQ did not obtain invoices, receipts, or other detailed documentation to adequately support matching expenditures funded by the State Clean Michigan Initiative.

DEQ awarded federal NPS funds and State Clean Michigan Initiative funds to grantees to carry out NPS Program activities. The grantees are required to provide match from local sources. DEQ required the grantees to submit quarterly financial reports but only required limited supporting documentation for match expenditures. DEQ's internal policy for Status Report and Project Documentation Requirements for all grants administered by the NPS Program requires subrecipients to submit copies of all invoices and receipts over \$500 used for federal reimbursement or match funds. Purchases under \$500 only require a listing of the purchases.

Federal regulation 40 *CFR* 31.24(b)(6) requires that costs counting toward satisfying a cost sharing or matching requirement must be verifiable from the records of grantees and subgrantees. Our review of the U.S. Environmental Protection Agency (EPA) requirements does not allow for the State to set a materiality threshold for the review of invoices or receipts.

We reported a similar condition in our prior single audit. DEQ indicated in its November 2011 corrective action plan that it implemented an updated match documentation form requiring grantees to document the basis for their match.

b. Subrecipient Monitoring

DEQ's internal control did not ensure compliance with the pass-through entity responsibilities as established in OMB Circular A-133.

We reviewed 5 subawards to assess DEQ's efforts to inform subrecipients of the required federal award information and to monitor subrecipients' activities and we reviewed 25 quarterly submissions for reimbursement by subrecipients. Also, we reviewed 32 subrecipients, of which 7 received NPS funding, to assess DEQ's efforts to obtain and review subrecipients' single audit reports and to issue management decisions.

Our review of DEQ's subrecipient monitoring efforts disclosed:

- (1) DEQ did not consistently monitor the activities of subrecipients to ensure that they used federal awards for authorized purposes. DEQ distributed \$5.7 million of the total \$7.6 million in NPS Program expenditures to subrecipients during fiscal years 2009-10 and 2010-11.

DEQ conducted desk reviews of quarterly expenditure reports submitted by the subrecipients during our audit period. However, as discussed in the Matching, Level of Effort, and Earmarking section (part a. of this finding), the documentation obtained to support the federal and/or local match expenditures in 2 of the 25 quarterly submissions we reviewed was not adequate to ensure compliance with federal requirements. Both of the quarterly expenditure reports included local match expenditures

for contractual services that were not adequately supported as required and are, therefore, also included in part a. of this finding.

OMB Circular A-133, Section 400(d) requires DEQ to monitor the activities of subrecipients to ensure that they used federal awards in compliance with federal laws and regulations. Federal regulation 40 *CFR* 31.40(a) also requires DEQ to monitor subrecipient activities to ensure compliance with laws, regulations, and the provisions of contracts or grant agreements.

We reported a similar condition in our prior single audit. DEQ indicated in its November 2011 corrective action plan that it will work to implement a new process to ensure that all match is reported on a quarterly basis.

- (2) During fiscal year 2009-10, DEQ did not receive a single audit report from one subrecipient that required a single audit report. This subrecipient was another State department. DEQ developed a tracking spreadsheet based on established subrecipient coding in the accounting records to help ensure that all required single audit reports were received. However, the tracking sheet did not include subrecipients that were other State departments.

OMB Circular A-133, Section 400(d) requires DEQ to ensure that subrecipients expending \$500,000 or more in federal awards meet the single audit requirements.

We reported a similar condition in the previous two single audits. DEQ indicated in its November 2011 corrective action plan that it would continue its effort to obtain 100% of the required audit reports.

- (3) During fiscal year 2010-11, DEQ did not receive a single audit report or verify that an audit report was not required for all 31 subrecipients related to the NPS Program. DEQ was in the process of establishing a service level agreement with MDE for subrecipient monitoring services; however,

the agreement did not take effect until October 1, 2011. Therefore, during fiscal year 2010-11, DEQ had the responsibility for obtaining and reviewing the subrecipients' single audit reports.

OMB Circular A-133, Section 400(d) requires DEQ to ensure that subrecipients expending \$500,000 or more in federal awards meet the single audit requirements. In addition, OMB Circular A-133, Section 400(d) requires DEQ to issue a management decision on subrecipient audit findings and ensure that the subrecipient takes appropriate and timely corrective action.

RECOMMENDATION

We again recommend that DEQ improve its internal control over the NPS Program to ensure compliance with federal laws and regulations regarding matching, level of effort, and earmarking and subrecipient monitoring.

FINDING (7611208)

8. Capitalization Grants for Drinking Water State Revolving Funds and ARRA - Capitalization Grants for Drinking Water State Revolving Funds, CFDA 66.468

U.S. Environmental Protection Agency	CFDA 66.468: Capitalization Grants for Drinking Water State Revolving Funds CFDA 66.468: ARRA - Capitalization Grants for Drinking Water State Revolving Funds
Award Number: FS-975487-05 FS-975487-06 FS-975487-07 FS-975487-08 FS-975487-09 FS-975487-10 2F-00E75101	Award Period: 10/01/2004 - 09/30/2010 10/01/2005 - 09/30/2011 10/01/2006 - 09/30/2012 10/01/2007 - 09/30/2012 10/01/2008 - 09/30/2013 10/01/2009 - 09/30/2014 10/01/2008 - 12/31/2013
	Known Questioned Costs: \$0

DEQ's internal control over the Capitalization Grants for Drinking Water State Revolving Funds* (DWSRF) Program did not ensure compliance with federal laws and regulations regarding reporting, subrecipient monitoring, and special tests and provisions.

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

Federal expenditures for the DWSRF Program totaled \$113.1 million for the two-year period ended September 30, 2011, including \$58.6 million in ARRA related expenditures.

Our exceptions, by compliance area, are as follows:

a. Reporting

DEQ did not have a process in place to verify the accuracy of the information contained in the ARRA Section 1512 report. Without adequate internal control, DEQ cannot ensure the completeness and accuracy of the ARRA Section 1512 report. As a result, in the ARRA Section 1512 report for the period ended June 30, 2011, DEQ reported inaccurate and/or incomplete information related to 2 (40%) of 5 subrecipients reviewed. DEQ overstated expenditures for these 2 subrecipients by \$2.7 million. In addition, DEQ understated its cumulative amount of ARRA expenditures on the June 2011 Section 1512 report by \$1.8 million.

OMB implementing guidance for ARRA provides that prime recipients, as owners of the data submitted, have principal responsibility for the quality of the information submitted.

We reported a similar condition in our prior single audit. DEQ indicated in its November 2011 corrective action plan that it would establish a process to review as many of the data elements as possible before the submission date. However, DEQ did not document that it completed this review.

* See glossary at end of report for definition.

b. Subrecipient Monitoring

DEQ's internal control did not ensure compliance with the pass-through entity responsibilities as established by OMB Circular A-133. Our review disclosed:

- (1) DEQ did not have a process in place to inform the subrecipients of the federal award number at the time of the subaward for the four supplemental agreements we reviewed.

OMB Circular A-133, Section 400(d) requires DEQ to inform each subrecipient of the federal award number.

- (2) During fiscal year 2010-11, DEQ did not receive a single audit report or verify that an audit report was not required for all 114 subrecipients related to the DWSRF Program. DEQ was in the process of establishing a service level agreement with MDE for subrecipient monitoring services; however, the agreement did not take effect until October 1, 2011. Therefore, during fiscal year 2010-11, DEQ had the responsibility for obtaining and reviewing the subrecipients' single audit reports.

OMB Circular A-133, Section 400(d) requires DEQ to ensure that subrecipients expending \$500,000 or more in federal awards meet the single audit requirements. In addition, OMB Circular A-133, Section 400(d) requires DEQ to issue a management decision on subrecipient audit findings and ensure that the subrecipient takes appropriate and timely corrective action.

We reported a similar condition in our two prior single audits. DEQ indicated in its November 2011 corrective action plan that it would continue its effort to obtain 100% of the required audit reports.

c. Special Tests and Provisions

DEQ's internal control did not ensure that it complied with federal laws and regulations regarding special test and provision requirements for ARRA funds. Our review disclosed:

- (1) As mentioned in part b.(1), DEQ did not have a process in place to inform the subrecipients of the federal award number at the time of subaward for the four supplemental agreements funded with ARRA funds. Also, DEQ did not inform the subrecipients of the federal award number and the amount of ARRA funds at the time of disbursement of funds.

DEQ's federal grant award terms and conditions provide that the grant award is subject to all applicable provisions of implementing guidance for ARRA issued by OMB. OMB implementing guidance requires DEQ to separately identify to each subrecipient, at the time of subaward and disbursement of funds, the federal award number, the *CFDA* number, and the amount of ARRA funds.

We reported a similar condition in our prior single audit. DEQ indicated in its November 2011 corrective action plan that it would modify the letters to contain the federal award number and the amount of ARRA funds.

- (2) DEQ did not have a process in place to inform the subrecipients of the requirement to include information to specifically identify ARRA funding on their data collection forms in the four supplemental agreements reviewed.

DEQ's federal grant award terms and conditions provide that the grant award is subject to all applicable provisions of implementing guidance for ARRA issued by OMB. OMB implementing guidance requires DEQ to have its subrecipients separately identify the expenditures for federal awards under ARRA on their SEFAs and data collection forms.

We reported a similar condition in our prior single audit. DEQ indicated in its November 2011 corrective action plan that it would modify the letters to include the information regarding the requirement to specifically identify ARRA funding on data collection forms.

RECOMMENDATION

We again recommend that DEQ improve its internal control over the DWSRF Program to ensure compliance with federal laws and regulations regarding reporting, subrecipient monitoring, and special tests and provisions.

FINDING (7611209)

9. Great Lakes Program, CFDA 66.469

U.S. Environmental Protection Agency	CFDA 66.469: Great Lakes Program
Award Number:	Award Period:
GL00E00697	09/01/2010 - 09/30/2013
GL00E00685	09/01/2010 - 12/31/2012
GL00E00714	09/01/2010 - 12/31/2012
GL00E00678	09/01/2010 - 12/31/2012
GL00E00661	09/01/2010 - 12/31/2012
GL00E00649	09/01/2010 - 12/31/2012
GL00E00662	09/01/2010 - 12/31/2012
GL00E00578	09/01/2010 - 12/31/2012
GL00E00512	09/01/2010 - 10/31/2012
GL00E00660	09/01/2010 - 12/31/2012
GL00E00612	09/10/2010 - 08/31/2015
GL00E00648	10/01/2010 - 09/30/2013
GL00E00414	09/02/2010 - 09/30/2014
GL00E09501	10/01/2006 - 09/30/2011
GL00E59201	10/01/2009 - 09/30/2103
GL00E00468	10/01/2010 - 09/30/2013
GL00E00477	08/01/2010 - 06/30/2012
30181AG071	06/03/2010 - 12/31/2011
	Known Questioned Costs: \$16,491

DEQ's internal control over the Great Lakes Program (GLP) did not ensure compliance with federal laws and regulations regarding allowable costs/cost principles and subrecipient monitoring. As a result, we identified known questioned costs of \$16,491.

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

Federal expenditures for GLP totaled \$5.6 million for the two-year period ended September 30, 2011.

Our exceptions, by compliance area, are as follows:

a. Allowable Costs/Cost Principles

DEQ's internal control did not ensure that GLP expenditures met the allowable cost principles of OMB Circular A-87 (federal regulation 2 *CFR* 225). As a result, we identified known questioned costs of \$16,491. Our review disclosed:

- (1) DEQ did not ensure that 4 (36%) of 11 GLP subrecipient reimbursements were paid for actual expenditures. In these instances, the expenditures were not supported by receipts or invoices for items such as travel, meals, and contractual services.
- (2) DEQ did not ensure that 2 (11%) of 18 contractual services payments were properly charged to GLP. In these instances, there were telecommunications inter-agency billings for telephone services charged to GLP for an employee who did not work on GLP.

Attachment A of OMB Circular A-87 (federal regulation 2 *CFR* 225) requires that costs charged to federal awards be adequately documented and be necessary and reasonable for the administration of the federal award.

b. Subrecipient Monitoring

DEQ's internal control did not ensure compliance with the pass-through entity responsibilities as established by OMB Circular A-133. Our review of DEQ subrecipient monitoring efforts disclosed:

- (1) We reviewed 11 subawards at the program level to assess DEQ's efforts to inform subrecipients of the required federal award information and to monitor subrecipients' activities.

Our review of DEQ subrecipient monitoring efforts disclosed that DEQ did not have a process in place to adequately monitor the activities of subrecipients to ensure that they complied with GLP requirements. DEQ distributed \$1.8 million of the total \$5.6 million in GLP expenditures to subrecipients during fiscal years 2009-10 and 2010-11.

DEQ monitors subrecipients at the program and division levels. DEQ's program staff are responsible for informing subrecipients of the *CFDA* title and number and federal award information. Also, program staff are responsible for monitoring subrecipients' activities to ensure that they use federal awards for authorized purposes.

DEQ conducted desk reviews of quarterly expenditure reports submitted by the subrecipients during our audit period. However, as described in part a.(1) of this finding, we noted that the documentation obtained to support the federal expenditures in 4 (36%) of 11 quarterly expenditure reports we reviewed was not adequate to ensure compliance with federal requirements.

OMB Circular A-133, Section 400(d) requires DEQ to monitor the activities of subrecipients to ensure that they used federal awards in compliance with federal laws, regulations, and the provisions of contracts or grant agreements. Federal regulation 40 *CFR* 31.40(a) also requires DEQ to monitor subrecipient activities to ensure compliance with federal laws and regulations.

- (2) During fiscal year 2010-11, DEQ did not receive a single audit report or verify that an audit report was not required for all 4 subrecipients related to GLP. DEQ was in the process of establishing a service level agreement with MDE for subrecipient monitoring services; however, the agreement did not take effect until October 1, 2011. Therefore, during fiscal year 2010-11, DEQ had the responsibility for obtaining and reviewing the subrecipients' single audit reports.

OMB Circular A-133, Section 400(d) requires DEQ to ensure that subrecipients expending \$500,000 or more in federal awards meet the single audit requirements. In addition, OMB Circular A-133, Section 400(d) requires DEQ to issue a management decision on subrecipient audit findings and ensure that the subrecipient takes appropriate and timely corrective action.

RECOMMENDATION

We recommend that DEQ improve its internal control over GLP to ensure compliance with federal laws and regulations regarding allowable costs/cost principles and subrecipient monitoring.

FINDING (7611210)

10. Performance Partnership Grants, CFDA 66.605

U.S. Environmental Protection Agency	CFDA 66.605: Performance Partnership Grants
Award Number: BG985023-10 BG985023-11	Award Period: 10/01/2009 - 09/30/2010 10/01/2010 - 09/30/2011
	Known Questioned Costs: \$490

DEQ's internal control over the Performance Partnership Grants (PPG) Program did not ensure compliance with federal laws and regulations regarding activities allowed or unallowed; allowable costs/cost principles; and matching, level of effort, and earmarking. As a result, we identified known questioned costs of \$490.

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

Federal expenditures for the PPG Program totaled \$27.3 million for the two-year period ended September 30, 2011.

Our exceptions, by compliance area, are as follows:

a. Activities Allowed or Unallowed

DEQ's internal control over the PPG Program did not ensure that expenditures charged were for allowed activities. As a result, we identified known questioned costs of \$294.

DEQ inappropriately obtained federal reimbursement for State vehicle usage without verifying that the vehicles were used for activities related to PPG. We reviewed 5 vehicle usage expenditures and related vehicle and employee time reports. DEQ could not provide sufficient documentation to support that the charges were only for employees working on PPG Program related activities.

Attachment B, section 43 of OMB Circular A-87, *Selected Items of Cost* (federal regulation 2 *CFR* 225), allows travel expenses to be charged to a federal program only when they specifically relate to the federal program.

b. Allowable Costs/Cost Principles

DEQ's internal control did not ensure that PPG Program expenditures met the allowable cost principles of OMB Circular A-87 (federal regulation 2 *CFR* 225). As a result, we identified known questioned costs of \$196.

DEQ did not maintain supporting documentation for 1 (4%) of 25 transactions. As discussed in the Activities Allowed or Unallowed section (part a. of this finding), DEQ did not maintain documentation to support that State vehicle usage charged to the PPG Program was for activities related to that Program. We questioned costs of \$294 in the Activities Allowed or Unallowed section (part a. of this finding).

Attachment A, sections C.1.b. and C.1.j. of OMB Circular A-87 (federal regulation 2 *CFR* 225) require that costs charged to federal programs be allocable to the grant and adequately documented, respectively.

c. Matching, Level of Effort, and Earmarking

DEQ's internal control did not ensure that it complied with federal laws and regulations regarding matching, level of effort, and earmarking.

As discussed in the Activities Allowed or Unallowed section (part a. of this finding) and the Allowable Costs/Cost Principles section (part b. of this finding), DEQ's State vehicle usage was charged to the PPG Program without verification that the vehicles were used for activities related to the PPG Program. We found that DEQ inappropriately applied the State's portion of these charges to satisfy its matching requirements to the PPG Program. However, because DEQ met the matching requirements for the PPG Program through additional match expenditures, we did not question these costs.

Federal regulation 40 *CFR* 31.24 requires that costs used for matching or cost sharing be applicable to the federal award.

RECOMMENDATION

We recommend that DEQ improve its internal control over the PPG Program to ensure compliance with federal laws and regulations regarding activities allowed or unallowed; allowable costs/cost principles; and matching, level of effort, and earmarking.

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 June 6, 2012

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, 2007 through September 30, 2009
Finding Number: 7611006
Finding Title: Performance Partnership Grants *CFDA*, 66.605

Finding: The Department of Environmental Quality's (DEQ's) internal control over the Performance Partnership Grants (PPG) Program did not ensure compliance with federal laws and regulations regarding allowable costs/cost principles; matching, level of effort, and earmarking; and reporting. Our review disclosed material weaknesses in internal control with compliance requirements related to reporting.

Agency Comments: This finding was the result of significant turnover in staff combined with a large increase in work load due to the American Recovery and Reinvestment Act of 2009 (ARRA) grant requirements. The underlying financial data was correct; an error was made in preparing the federal financial report. DEQ conducted training with employees preparing the federal financial reports and emphasized the importance of supervisory review during fiscal year 2009-10. DEQ implemented a new process

during the audit period that improved internal control over the payroll certification process. Due to human error in implementing the process, one certification was omitted during the review process. DEQ has implemented an additional supervisory review procedure to provide additional assurance that all required certifications are obtained.

Audit Findings Not Corrected or Partially Corrected:

Audit Period: October 1, 2007 through September 30, 2009

Finding Number: 7611001

Finding Title: Coastal Zone Management Administration Awards, *CFDA* 11.419

Finding: DEQ's internal control over the Coastal Zone Management Administration Awards (CZM) Program did not ensure compliance with federal laws and regulations regarding allowable costs/cost principles; matching, level of effort, and earmarking; and subrecipient monitoring.

Agency Comments: DEQ requires all employees, including administrative employees, to directly cost account their time. Administrative time is no longer allocated to federal grants. DEQ implemented revised reporting requirements with the 2009 award cycle. Detailed documentation is now required for payroll, travel, equipment, supplies, and other contractual expenses. DEQ implemented a revised subrecipient audit monitoring process, including a supervisory review, during the 2010 review cycle. For the 2011 review cycle, DEQ entered into a service level agreement and a memorandum of understanding with the Michigan Department of Education (MDE) Service Center. MDE will provide the monitoring services to DEQ.

Audit Period: October 1, 2007 through September 30, 2009
Finding Number: 7611002
Finding Title: Air Pollution Control Program Support, *CFDA* 66.001

Finding: DEQ's internal control over Air Pollution Control Program Support did not ensure compliance with federal laws and regulations regarding allowable costs/cost principles; matching, level of effort, and earmarking; and reporting.

Agency Comments: DEQ submitted a request for an enhancement to the Data Collection and Distribution System (DCDS) to accommodate the requirement that employees agree to changes made to their time sheets by others. Division administrative staff members were reminded to maintain documentation of employees' agreement with time sheet changes submitted by others. DEQ continues to disagree with the finding regarding the method of recording expenditures. DEQ agreed to implement an accounting solution to separately identify activities required by the grant award at such time as the U.S. Environmental Protection Agency (EPA) Region V administrator confirms the interpretation made by the Michigan Office of the Auditor General. To date, DEQ has not received any indication that Region V officials support the auditors' interpretation.

Audit Period: October 1, 2007 through September 30, 2009
Finding Number: 7611003
Finding Title: Capitalization Grants for Clean Water State Revolving Funds, *CFDA* 66.458

Finding: DEQ's internal control over the Capitalization Grants for Clean Water State Revolving Funds (CWSRF) Program did not ensure compliance with federal laws and regulations regarding activities allowed or unallowed; allowable costs/cost principles; matching, level of effort, and earmarking; procurement and suspension and debarment; reporting; subrecipient monitoring; and special tests and provisions.

Agency Comments: A new process for approving reimbursement requests was implemented during fiscal year 2007-08; additional training and follow-up were implemented during fiscal year 2008-09 and continued in succeeding fiscal years. DEQ stopped allocating administrative costs to CWSRF grants during fiscal year 2008-09. All employees, including administrative employees, now cost account their hours. Additional training and follow-up were completed to remind program managers of the requirement to document that the Excluded Parties List System was checked. Prior to the July 12, 2011 reporting deadline, DEQ revised the instructions to subrecipients regarding calculation of jobs created/retained. DEQ continues to use the cross-cutter checklist to document the completion of the environmental reviews. Additional training and follow-up on the use of the checklist were implemented during fiscal year 2008-09 and continued in succeeding fiscal years. DEQ established a process to review as many of the data elements as possible before the submission deadline. Errors discovered after the due date are corrected during the next reporting cycle. Although DEQ disagrees in part with the findings regarding compliance with the Davis-Bacon Act and the Buy American Act, it adopted the EPA's State ARRA Inspection Checklist and began to use it early in fiscal year 2009-10. In early 2010, DEQ modified the letters sent to subrecipients at the time of each draw to include the award number, the amount of ARRA funds awarded, and the requirement to specifically identify ARRA funding on the schedule of expenditures of federal awards (SEFA).

Audit Period: October 1, 2007 through September 30, 2009
Finding Number: 7611004
Finding Title: Nonpoint Source Implementation Grants, *CFDA* 66.460

Finding: DEQ's internal control over the Nonpoint Source Implementation Grants (NPS) Program did not ensure compliance with federal laws and regulations regarding allowable costs/cost principles; matching, level of effort, and earmarking; and subrecipient monitoring.

Agency Comments: DEQ stopped allocating administrative costs to NPS grants during fiscal year 2008-09. All employees, including administrative staff, cost account their hours. Guidance was developed and implemented during 2011 to address the issues of propriety of matching expenditures, adequacy of supporting documentation, monitoring of matching expenditures, and the requirement to pay based on actual billings. DEQ implemented a revised subrecipient audit monitoring process, including a supervisory review, during the 2010 review cycle. For the 2011 review cycle, DEQ entered into a service level agreement and a memorandum of understanding with the MDE Service Center. MDE will provide the monitoring services to DEQ. DEQ submitted a request for an enhancement to DCDS to accommodate the requirement that employees agree to changes made to their time sheets by others. Division administrative staff members were reminded to maintain documentation of employees' agreement with time sheet changes submitted by others. DEQ continues to disagree with the auditors' findings regarding the identification of administrative costs and the exclusion of indirect costs allocated to the program based on programmatic salaries. DEQ has exchanged a series of letters with EPA Region V officials requesting an opinion regarding the interpretation of the regulations. To date, DEQ has not received any indication that Region V officials support the auditors' interpretation, nor has the EPA requested repayment of the questioned costs associated with this finding.

Audit Period: October 1, 2007 through September 30, 2009

Finding Number: 7611005

Finding Title: Capitalization Grants for Drinking Water State Revolving Funds, *CFDA 66.468*

Finding: DEQ's internal control over the Capitalization Grants for Drinking Water State Revolving Funds (DWSRF) Program did not ensure compliance with federal laws and regulations regarding allowable costs/cost principles, procurement and suspension and debarment, reporting, subrecipient monitoring, and special tests and provisions.

Agency Comments: A new process for approving reimbursement requests was implemented during fiscal year 2007-08; additional training and follow-up were implemented during fiscal year 2008-09 and continued in succeeding fiscal years. DEQ stopped allocating administrative costs to DWSRF grants during fiscal year 2008-09. All employees, including administrative employees, now cost account their hours. Additional training and follow-up were completed to remind programs managers of the requirement to document that the Excluded Parties List System was checked. DEQ clarified the financial reporting requirements and conducted training with staff members and re-emphasized supervisory review. Prior to the July 12, 2011 deadline, DEQ revised the instructions to subrecipients regarding calculation of jobs created/retained. Additional training and follow-up on the use of the checklist were implemented during fiscal year 2008-09 and continued in succeeding fiscal years. DEQ established a process to review as many of the data elements as possible before the submission deadline. Errors discovered after the due date are corrected during the next reporting cycle. Although DEQ disagrees in part with the findings regarding compliance with the Davis-Bacon Act and the Buy American Act, it adopted the EPA's State ARRA Inspection Checklist and began to use it early in fiscal year 2009-10. In early 2010, DEQ modified award letters sent to subrecipients at the time of each draw to include the award number, the amount of ARRA funds awarded, and the requirement to specifically identify ARRA funding on the SEFA.

DEPARTMENT OF ENVIRONMENTAL QUALITY

Corrective Action Plan

As of June 5, 2012

FINDINGS RELATED TO THE FINANCIAL STATEMENTS AND FINANCIAL SCHEDULES

Finding Number: 7611201
Finding Title: State Compliance

Management Views: The State needs to maintain flexibility so that bond sales occur when the market is advantageous. In this situation, the need for flexibility caused the expenditures and bond sale to occur in different fiscal years.

Planned Corrective Action: The Department of Environmental Quality (DEQ) and the Department of Technology, Management, and Budget (DTMB) sought legislation to clarify that the transactions processed in this situation are allowable.

The boilerplate language requested and included in Article VII of Enrolled House Bill 5365 for the fiscal year 2012-13 budget is as follows:

Sec. 310. (1) Upon approval by the state budget director, the department may expend from the general fund of the state an amount to meet the cash-flow requirements of projects funded under any of the following that are financed from bond proceeds and for which bonds have been authorized but not issued:

- (a) Part 52 of the natural resources and environmental protection act, 1994 PA 451, MCL 324.5201 to 324.5206.

- (b) Part 193 of the natural resources and environmental protection act, 1994 PA 451, MCL 324.19301 to 324.19306.
- (c) Part 196 of the natural resources and environmental protection act, 1994 PA 451, MCL 324.19601 to 324.19616.
- (2) Upon the sale of bonds for projects described in subsection (1), the department shall credit the general fund of the state in an amount equal to that expended from the general fund.

Anticipated Completion Date: October 1, 2012

Responsible Individuals: Jane Schultz and Amy Henderson

FINDINGS RELATED TO FEDERAL AWARDS

Finding Number: 7611202
Finding Title: Coastal Zone Management Administration Awards, *CFDA* 11.419

Management Views: DEQ agrees with Finding 2 and has already complied with the corresponding recommendation. DEQ entered into a service level agreement with the Michigan Department of Education (MDE) for subrecipient monitoring services, effective October 1, 2011.

Planned Corrective Action: No additional corrective action is necessary.

Anticipated Completion Date: Complete

Responsible Individual: Sharon Maher

Finding Number: 7611203
Finding Title: Air Pollution Control Program Support, *CFDA* 66.001

Management Views: DEQ continues to disagree with Finding 3. DEQ disagrees with the auditors' interpretation of the grant regulations and awaits the U.S. Environmental Protection Agency's (EPA's) clear guidance which was requested by DEQ's Administration Division Chief in May 2011. DEQ has agreed to implement an accounting solution to separately identify activities required by the grant award if the EPA confirms the interpretation made by the auditors. The EPA has not responded to this request and continues to accept the maintenance of effort calculation prepared by DEQ each year.

Planned Corrective Action: DEQ will continue to seek guidance from the EPA on this issue.

Anticipated Completion Date: September 30, 2012

Responsible Individuals: Sharon Maher and Michael Jackson

Finding Number: 7611204
Finding Title: State Clean Diesel Grant Program and ARRA - State Clean Diesel Grant Program, *CFDA* 66.040

Management Views: DEQ agrees with Finding 4, part a. and has already complied with the corresponding recommendation by entering into a service level agreement with MDE for subrecipient monitoring services, effective October 1, 2011.

DEQ agrees in part with Finding 4, part b. and has already complied with the corresponding recommendation. DEQ did not receive timely guidance from the EPA regarding the requirement that American Recovery and Reinvestment Act of 2009 (ARRA) funding should be noted separately on the schedule of expenditures of federal awards (SEFA) and the data collection form. The EPA was diligent in providing guidance on other ARRA requirements using webinars and guidance memorandums. However, this requirement was not addressed as the EPA continuously worked with states to get the ARRA funds allocated by the February 17, 2010 deadline. The EPA headquarters office for the program noted that the terms and conditions of the grant award are subject to interpretation by the EPA guidance. Lack of guidance from the EPA in this area is an indicator that this was not a primary concern of the federal agency.

DEQ has added the requirement that the subrecipients separately identify the expenditures for federal awards under ARRA on the SEFA and the data collection form to the letters that subrecipients receive at the time of disbursement of funds.

Planned Corrective Action: No additional corrective action is necessary.

Anticipated Completion Date: Complete

Responsible Individual: Sharon Maher

Finding Number: 7611205

Finding Title: State Public Water System Supervision, *CFDA* 66.432

Management Views: DEQ agrees with Finding 5, parts a., b., and c. and will comply.

Planned Corrective Action: DEQ will work to improve its internal control over vehicle usage by implementing a monthly process to review vehicle travel charges at the employee level. Division administration will coordinate the review with supervisors as needed to ensure that charges are appropriate and support State Public Water System Supervision (PWSS) Program activities. In addition, DEQ will evaluate the current Vehicle Reservation System (VRS) and determine if there are options available to revise the current reservation process to allow for prior supervisory review and approval of travel and related account coding.

Anticipated Completion Date: December 31, 2012

Responsible Individuals: Sharon Maher and Division Budget Liaisons

Finding Number: 7611206

Finding Title: Capitalization Grants for Clean Water State Revolving Funds and ARRA - Capitalization Grants for Clean Water State Revolving Funds, *CFDA* 66.458

Management Views: DEQ agrees with Finding 6, part a. that there is no formal process to review information submitted by subrecipients prior to the submission of the ARRA Section 1512 reports. Given the tight reporting schedule, there is not adequate time to extensively review and validate all of the information submitted by subrecipients prior to the due date, which is ten calendar days after each quarter end. DEQ established a process to review as many of the data elements as possible before the submission date. Errors discovered after the due date are corrected during the next reporting cycle, as U.S. Office of Management and Budget (OMB) regulations allow.

To allow for accurate reporting, DEQ provided the subrecipients five days to complete the report and return it to DEQ. The data collection forms are reviewed for pertinent and complete information (e.g., the monthly jobs, hours worked, and payroll amounts are calculated properly; an accurate project number is included, and the subrecipient Data Universal Numbering System [DUNS] number and zip code contain nine digits). There was not sufficient time to ensure that all vendors had been reported on the data collection forms. In some cases, not all contracts had been awarded by the subrecipients to the vendors.

Given that no errors were reported, DEQ believes that it has implemented a responsible process to ensure the most accurate reporting possible given the very short reporting window.

DEQ agrees with Finding 6, part b.(2) and has already complied with the corresponding recommendation by entering into a service level agreement with MDE for subrecipient monitoring services, effective October 1, 2011.

DEQ agrees in part with Finding 6, parts b.(1), c.(1), and c.(2) and has already complied with the corresponding recommendation. DEQ did not receive timely guidance from the EPA regarding these requirements. Previously, subrecipients were not provided with the federal award number at the time of subaward or at the time of disbursement of funds. At the time of disbursement of funds, subrecipients were told the *CFDA* number and the distribution between federal and State funding sources. DEQ also did not receive timely guidance from the EPA regarding the requirement that ARRA funding should be noted

separately on the SEFA and the data collection form. The EPA was diligent in providing guidance on other ARRA requirements using webinars and guidance memorandums. However, these requirements were not addressed as the EPA continuously worked with states to get the ARRA funds allocated by the February 17, 2010 deadline. The EPA headquarters office for the program noted that the terms and conditions of the grant award are subject to interpretation by the EPA guidance. Lack of guidance from the EPA in this area is an indicator that this was not a primary concern of the federal agency.

DEQ has added the federal award number to the letters that subrecipients receive at the time of disbursement of funds. DEQ has also added the requirement that the subrecipients separately identify the expenditures for federal awards under ARRA on the SEFA and the data collection form to the letters that subrecipients receive at the time of disbursement of funds.

Planned Corrective Action: No additional corrective action is necessary.

Anticipated Completion Date: Complete

Responsible Individuals: Sharon Maher and Sonya Butler

Finding Number: 7611207

Finding Title: Nonpoint Source Implementation Grants,
CFDA 66.460

Management Views: DEQ agrees with the facts in Finding 7, parts a. and b.(1); however, the Nonpoint Source Implementation Grants (NPS) Program implemented a \$500 threshold

where costs under \$500 do not require receipts. The program requires the subrecipient to submit a list of items purchased to validate charges. In addition, DEQ project administrators ensure that all costs are consistent with the contract. While Title 40, Part 31, section 24 of the *Code of Federal Regulations (CFR)* requires costs to be verifiable from the records of grantees and subgrantees, it does not state that DEQ has to collect and have on file all such documentation. The *CFR* also states that DEQ is to "have primary responsibility for employing whatever form of organization and management techniques may be necessary to assure proper and efficient administration of Federal awards" and have "efficient and effective administration of Federal awards through the application of sound management practices." DEQ's practices are effective and efficient and the risk involved in costs under \$500 is minimal.

DEQ agrees with Finding 7, parts b.(2) and b.(3) and has already complied with the corresponding recommendation.

Planned Corrective Action:

Regarding Finding 7, part b.(1), DEQ will develop formal policies and procedures to implement the process where a sample of the expenditures reported that are under \$500 is selected. Documentation supporting these expenditures included in the sample will be requested and reviewed.

Regarding Finding 7, parts b.(2) and b.(3), DEQ entered into a service level agreement with MDE for subrecipient monitoring services, effective October 1, 2011.

Anticipated Completion Date: March 30, 2013

Responsible Individuals: Sharon Maher and Cindy Masterson

Finding Number: 7611208

Finding Title: Capitalization Grants for Drinking Water State Revolving Funds and ARRA - Capitalization Grants for Drinking Water State Revolving Funds, *CFDA* 66.468

Management Views: DEQ agrees with Finding 8, part a. that there is no formal process to review information submitted by subrecipients prior to the submission of the ARRA Section 1512 reports. Given the tight reporting schedule, there is not adequate time to extensively review and validate all of the information submitted by subrecipients prior to the due dates. DEQ established a process to review as many of the data elements as possible before the submission date. Errors discovered after the due date are corrected during the next reporting cycle, as OMB regulations allow.

DEQ agrees with Finding 8, part b.(2) and has already complied with the corresponding recommendation. DEQ entered into a service level agreement with MDE for subrecipient monitoring services, effective October 1, 2011.

DEQ agrees in part with Finding 8, parts b.(1), c.(1), and c.(2) and has already complied with the corresponding recommendation. DEQ did not receive timely guidance from the EPA regarding these requirements. Previously, subrecipients were not provided with the federal award number at the time of subaward or at the time of disbursement of funds. At the time of disbursement of funds, subrecipients were told the *CFDA* number and the distribution between

federal and State funding sources. DEQ also did not receive timely guidance from the EPA regarding the requirement that ARRA funding should be noted separately on the SEFA and the data collection form. The EPA was diligent in providing guidance on other requirements using webinars and guidance memorandums; however, these requirements were not addressed. Lack of guidance from the EPA in this area is an indicator that this was not a primary concern of the federal agency.

The EPA performed program reviews on May 2010, December 2010, June 2011, and October 2011 to ensure that DEQ was meeting the grant requirements. Each time, the DEQ disbursement process for Drinking Water State Revolving Funds (DWSRF) funds was reviewed and tested, and the EPA noted no findings or recommendations.

DEQ has added the federal award number to the letters that subrecipients receive at the time of disbursement of funds. DEQ has also added the requirement that the subrecipients separately identify the expenditures for federal awards under ARRA on the SEFA and the data collection form to the letters that subrecipients receive at the time of disbursement of funds as of February 2010.

Planned Corrective Action: No additional corrective action is necessary.

Anticipated Completion Date: Complete

Responsible Individual: Sharon Maher and Sonya Butler

Finding Number: 7611209

Finding Title: Great Lakes Program, *CFDA* 66.469

Management Views: DEQ agrees with Finding 9, parts a.(1) and a.(2) and will comply. DEQ changed its practice of accepting summary documentation when determining allowable costs. Subrecipients are now required to submit reimbursement documentation with receipts or invoices for expenditures.

DEQ agrees with Finding 9, parts b.(1) and b.(2) and has already complied with the corresponding recommendation. DEQ entered into a service level agreement with MDE for subrecipient monitoring services, effective October 1, 2011.

Planned Corrective Action: DEQ staff contacted the grantees to obtain all required supporting documentation to verify that the amounts reimbursed to the grantees were correct. The program is currently in the process of providing additional guidance to staff on the information that must be contained as support when approving an invoice for payment. This guidance will be implemented for all Great Lakes Initiative Projects.

Anticipated Completion Date: September 30, 2012

Responsible Individuals: Sharon Maher and Division Budget Liaisons

Finding Number: 7611210

Finding Title: Performance Partnership Grants, *CFDA* 66.605

Management Views: DEQ agrees with Finding 10, parts a., b., and c. and will comply.

Planned Corrective Action: DEQ will work to improve its internal control over vehicle usage by implementing a monthly process to review vehicle travel charges at the employee level.

Division administration will coordinate the review with supervisors as needed to ensure that charges are appropriate and support Performance Partnership Grant (PPG) activities. In addition, DEQ will evaluate the current Vehicle Reservation System (VRS) and determine if there are options available to revise the current reservation process to allow for prior supervisory review and approval of travel and related account coding.

Anticipated Completion Date: March 31, 2013

Responsible Individuals: Sharon Maher and Division Budget Liaisons

GLOSSARY

Glossary of Acronyms and Terms

American Recovery and Reinvestment Act of 2009 (ARRA)	An economic stimulus package enacted by the 111th United States Congress in February 2009.
Capitalization Grants for Clean Water State Revolving Funds (CWSRF) 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.
Capitalization Grants for Drinking Water State Revolving Funds (DWSRF) Program	The federal grant program that provides capitalization grants to states for establishing revolving funds to be used to assist public water suppliers in financing the costs of infrastructure needed to achieve or maintain compliance with Safe Drinking Water Act requirements. States may also set aside certain percentages of their capitalization grant for various activities that promote source water protection and enhanced water systems management.
<i>Catalog of Federal Domestic Assistance (CFDA)</i>	The catalog that provides a full listing, with detailed program descriptions, of all federal programs available to state and local governments.
<i>Code of Federal Regulations (CFR)</i>	The codification of the general and permanent rules published by the departments and agencies of the federal government.
CRF	Cleanup and Redevelopment Sub-Fund.
CRTF	Cleanup and Redevelopment Trust Sub-Fund.

CZM	Coastal Zone Management Administration Awards.
Data Collection and Distribution System (DCDS)	The State's client/server system that records, allocates, and distributes payroll costs within the accounting system.
deficiency in internal control over federal program compliance	The design or operation of a control over compliance that does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis.
deficiency in internal control over financial reporting	The design or operation of a control that does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.
DEQ	Department of Environmental Quality.
DNR	Department of Natural Resources.
DNRE	Department of Natural Resources and Environment.
DTMB	Department of Technology, Management, and Budget.
EPA	U.S. Environmental Protection Agency.
ERF	Environmental Response Fund.
financial audit	An audit that is designed to provide reasonable assurance about whether the financial statements and/or financial schedules of an audited entity are presented fairly in all material respects in conformity with the disclosed basis of accounting.

GASB 54	GASB Statement No. 54, <i>Fund Balance Reporting and Governmental Fund Type Definitions</i> .
generally accepted accounting principles (GAAP)	A technical accounting term that encompasses the conventions, rules, guidelines, and procedures necessary to define accepted accounting practice at a particular time; also cited as "accounting principles generally accepted in the United States of America."
GLP	Great Lakes Program.
Governmental Accounting Standards Board (GASB)	An arm of the Financial Accounting Foundation established to promulgate standards of financial accounting and reporting with respect to activities and transactions of state and local governmental entities.
internal control	A process, effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance about the achievement of the entity's objectives with regard to 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 statements and/or financial schedules that causes the statements and/or schedules 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, regulations, contracts, and grants that could have a direct and material effect on major federal programs or on financial statement and/or financial schedule amounts.
material weakness in internal control over federal program compliance	A deficiency, or a combination of deficiencies, in internal control over compliance such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.
material weakness in internal control over financial reporting	A deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the financial statements and/or financial schedules will not be prevented, or detected and corrected, on a timely basis.
MDE	Michigan Department of Education.
NPS	Nonpoint Source Implementation Grants.
pass-through entity	A nonfederal entity that provides a federal award to a subrecipient to carry out a federal program.
PPG	Performance Partnership Grants.
PWSS	State Public Water System Supervision.
qualified opinion	An auditor's opinion in which the auditor: <ul style="list-style-type: none"> a. Identifies a scope limitation or one or more instances of misstatements that impact the fair presentation of the financial statements and/or financial schedules presenting the basic financial information of the audited entity in conformity with the disclosed basis of

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

- b. Identifies a scope limitation or material noncompliance with one or more of the cited compliance requirements that are applicable to each major federal program.

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.

SEFA

schedule of expenditures of federal awards.

significant deficiency in internal control over federal program compliance

A deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

significant deficiency in internal control over financial reporting	A deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.
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 <i>Government Auditing Standards</i> 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	<i>State of Michigan Comprehensive Annual Financial Report.</i>
subrecipient	A nonfederal entity that expends federal awards received from another nonfederal entity to carry out a federal program.
SWQIF	Strategic Water Quality Initiatives Fund.
TCE	trichloroethylene.
unqualified opinion	An auditor's opinion in which the auditor states that: <ul style="list-style-type: none"> a. The financial statements and/or financial schedules presenting the basic financial information of the audited entity are fairly presented in conformity with the disclosed basis of accounting; or

- b. The financial statements and/or financial schedule presenting supplemental financial information are fairly stated in relation to the basic financial statements and/or financial schedules. In issuing an "in relation to" opinion, the auditor has applied auditing procedures to the supplemental financial statements and/or financial schedule to the extent necessary to form an opinion on the basic financial statements and/or financial schedules, but did not apply auditing procedures to the extent that would be necessary to express an opinion on the supplemental financial statements and/or financial schedule taken by themselves; or
- c. The audited entity complied, in all material respects, with the cited compliance requirements that are applicable to each major federal program.

U.S. Office of
Management and
Budget (OMB)

A cabinet-level office that assists the President in overseeing the preparation of the federal budget and in supervising its administration in executive branch agencies.

