New Jersey State Legislature
Office of Legislative Services
Office of the State Auditor

Department of Environmental Protection
Water Funds

July 1, 2003 to September 30, 2005

Richard L. Fair
State Auditor
The Honorable Richard J. Codey  
Acting Governor of New Jersey

The Honorable Richard J. Codey  
President of the Senate

The Honorable Albin Sires  
Speaker of the General Assembly

Mr. Albert Porroni  
Executive Director  
Office of Legislative Services

Enclosed is our report on the audit of the Department of Environmental Protection, Water Funds for the period of July 1, 2003 to September 30, 2005. If you would like a personal briefing, please call me at (609) 292-3700.

Richard L. Fair  
State Auditor  
December 20, 2005
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Department of Environmental Protection  
Water Funds

Scope


The primary objective of these special revenue funds within our scope is to provide loans, grants and administrative support to assure the state’s water resources and wastewater processes meet public health requirements. Total expenditures for the water funds for the audit period were $128 million. The major components of expenditures were payments for debt service reserve, grants, and administrative costs. In addition, loan payments, which are not considered expenditures on the financial statements, totaled $248 million. Revenues for the audit period totaled $282 million and were primarily derived from federal grants, bond proceeds, and taxes.

Objectives

The objectives of our audit were to determine whether financial transactions and balances were related to the water funds, were appropriate per enabling legislation, were reasonable, and were recorded properly in the accounting systems. In addition, we tested for compliance with the governing administrative code applicable to the loan application and approval process for the Wastewater Treatment Fund, 1992 Wastewater Treatment Fund, Drinking Water State Revolving
Fund, and the Water Supply Fund.

This audit was conducted pursuant to the State Auditor's responsibilities as set forth in Article VII, Section 1, Paragraph 6 of the State Constitution and Title 52 of the New Jersey Statutes.

 Methodology

Our audit was conducted in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

In preparation for our testing, we studied legislation, administrative code, circular letters promulgated by the State Comptroller, and policies of the department. Provisions that we considered significant were documented and compliance with those requirements was verified by interview, observation and through our samples of financial transactions. We reviewed financial trends, and interviewed department personnel to obtain an understanding of the programs and internal controls.

A nonstatistical sampling approach was used. Our samples of financial transactions were designed to provide conclusions about the validity of transactions as well as internal control and compliance attributes. Transactions were judgmentally selected for testing.

 Conclusions

We found that the financial transactions and balances included in our testing were related to the water funds, were appropriate per enabling legislation, were reasonable, and were recorded properly in the accounting systems. In addition, we found that the loan application and approval process was in compliance with the applicable governing administrative code. In making these determinations, we noted two internal control weaknesses meriting management’s attention.
Unused funds of $3.5 million should be returned to their funding sources for new projects.

Escrow Balances

The department had entered into agreements with the Army Corp of Engineers (ACOE) for various projects dating as far back as the 1980s. The department’s estimated share of the costs were placed in escrow accounts for the ACOE to draw on as projects proceeded. Our review disclosed that the escrow accounts have not had withdrawals from 3 to 16 years. Department officials state that all eight projects are complete. The balance of funds in the escrow accounts total $3.5 million. The source of the funds for these accounts include not only the Natural Resource Fund ($0.6 million) which is in our audit scope, but also the General Fund ($1.5 million), Beaches and Harbor Fund ($1.3 million), and the Shore Protection Fund ($0.1 million). The funds can not be released from escrow without the bank receiving a signed certification from the ACOE and the state. The department has not been able to provide evidence that they have requested the certification from the ACOE. Releasing the funds to their source would allow them to be put to use on other projects.

Recommendation

We recommend that the Department officially request written certification from the Army Corp of Engineers to release state funds from escrow and return them to their original funding source.

Cash Receipts Process

We noted an internal control weakness in the loan repayment cash receipt process at the department’s trust fund accounting office. The employee that posts all cash receipts to a mail log and later ensures that all checks have been deposited is also responsible for the recording to
subsidiary records, depositing, creating the New Jersey Comprehensive Financial System (NJCF)
Cash Receipt transaction for recording to NJCFS, and billing for four of the water funds. These
functions are not compatible and increase the risk of loss of cash payments. This weakness began
when the section supervisor who had performed the mail log function was reassigned to a special
project in November 2004. This employee processed 134 checks totaling $5.8 million from
November 1, 2004 to September 30, 2005. Additional testing disclosed no improprieties.
These functions should be segregated to reduce the risk of errors or irregularities from occurring
and not being detected in a timely manner.

**Recommendation**

We recommend that the trust fund accounting office assign the maintenance of the mail log to
someone other than an employee that has other cash receipt duties.
Mr. Richard L. Fair
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Office of Legislative Services
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Dear Mr. Fair:

Thank you for the opportunity to review and respond to the draft audit report regarding the Department of Environmental Protection, Water Funds, for the period of July 1, 2003 to September 30, 2005. We are pleased to note that the audit concludes that the financial transactions and balances tested were related to the water funds, were appropriate as per enabling legislation and were both reasonable and properly recorded in the State’s accounting system. The Department is equally pleased with the fact that our loan application and approval process was found to be in compliance with applicable governing administrative codes.

The audit report also noted two internal control weaknesses which merit management’s attention. We hereby offer our planned corrective actions to address these issues and their corresponding recommendations.

Escrow Balances

The Department concurs with the recommendation to petition the Army Corps of Engineers to allow us to release State funds from dormant escrow accounts and return the funds to the original funding sources for use on other projects. We have drafted correspondence to both the Philadelphia and New York District Offices of the Corps to request written certification which would authorize the financial institutions holding the escrow accounts to close said accounts and return the funds to appropriate operating accounts.

Cash Receipts Process

The recommendation relative to the Trust Fund Accounting Office loan repayment processing, specifically, proper segregation of duties, has been duly noted and addressed. As noted in the report, the weakness, upon which additional testing disclosed no improprieties, occurred only during the temporary reassignment of key supervisory personnel to other Departmental priorities. This one-year supervisory deployment terminates on December 16, 2005, at which time, the
previously utilized segregation of duties relating to receipt processing will be reinstated, thus ensuring that the risk of undetected errors or irregularities will be minimized.

In closing, the Department accepts the positive conclusions presented in the report and will strive to implement both recommendations in order to safeguard the State's assets and interests.

Sincerely,

[Signature]

Bradley M. Campbell
Commissioner