



John Keel, CPA
State Auditor

A Report on

**State of Texas Compliance with
Federal Requirements for
Selected Major Programs at the
Water Development Board
for the Fiscal Year Ended
August 31, 2014**

February 2015

Report No. 15-025



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Overall Conclusion

The State of Texas complied in all material respects with the federal requirements for the Capitalization Grants for Clean Water State Revolving Funds Program (Clean Water Program) and the Capitalization Grants for Drinking Water State Revolving Funds Program (Drinking Water Program) in fiscal year 2014.

As a condition of receiving federal funding, U.S. Office of Management and Budget (OMB) Circular A-133 requires non-federal entities that expend at least \$500,000¹ in federal awards in a fiscal year to obtain annual Single Audits. Those audits test compliance with federal requirements in up to 14 areas that may have a material effect on a federal program at those non-federal entities. Examples of types of compliance areas include allowable costs, cash management, and monitoring of non-state entities (subrecipients) to which the State passes federal funds. The requirements for 1 of those 14 areas vary by federal program and outline special tests that auditors are required to perform, such as requirements related to environmental reviews and financial commitments that the Water Development Board (Board) is required to make to its subrecipients. The Single Audit for the State of Texas included (1) all high-risk federal programs for which the State expended more than \$73,923,376 in federal funds during fiscal year 2014 and (2) other selected federal programs.

From September 1, 2013, through August 31, 2014, the State of Texas expended \$49.1 billion in federal funds. The State Auditor's Office audited compliance with requirements for the Clean Water Program and the Drinking Water Program at the Board, which spent \$159.7 million in federal Clean Water Program funds and \$78.7 million in federal Drinking Water Program funds during fiscal year 2014.

The Capitalization Grants for Clean Water State Revolving Funds Program

The Capitalization Grants for Clean Water State Revolving Funds Program (Clean Water Program), which is administered by the U.S. Environmental Protection Agency, provides states with a long-term source of financing for construction of wastewater treatment facilities and other water quality management activities.

The Capitalization Grants for Drinking Water State Revolving Funds Program

The Capitalization Grants for Drinking Water State Revolving Funds Program (Drinking Water Program), which is administered by the U.S. Environmental Protection Agency, provides states with a long-term source of financing the costs of drinking water infrastructure.

¹ Title 2, Code of Federal Regulations, Section 200, supersedes OMB Circular A-133 and, for fiscal years beginning on or after December 26, 2014, increases the Single Audit threshold to \$750,000 in federal expenditures in a fiscal year.

Key Points

The Board complied in all material respects with requirements that could have a direct and material effect on the Clean Water Program and the Drinking Water Program.

Auditors did not identify any reportable findings at the Board (see text box for definitions of reportable finding classifications).

In addition, the Board fully implemented recommendations for both findings from the prior fiscal year related to the Clean Water Program and the Drinking Water Program.

Summary of Information Technology Review

The audit work included a review of general and application controls for key information technology systems related to the Clean Water Program and the Drinking Water Program. As discussed above, auditors did not identify reportable findings at the Board.

Summary of Objectives, Scope, and Methodology

With respect to the Clean Water Program and the Drinking Water Program, the objectives of this audit were to (1) obtain an understanding of internal controls over compliance, assess the control risk of noncompliance, and perform tests of those controls unless the controls were deemed to be ineffective and (2) provide an opinion on whether the State complied with the provisions of laws, regulations, and contracts or grants that have a direct and material effect on those programs.

The audit scope covered federal funds that the State spent for the Clean Water Program and the Drinking Water Program at the Board from September 1, 2013, through August 31, 2014. The audit work included control and compliance tests at the Board.

The audit methodology included developing an understanding of controls over each compliance area that was direct and material to the Clean Water Program and the Drinking Water Program. Auditors' sampling methodology was based on the American Institute of Certified Public Accountants' audit guide entitled *Government Auditing Standards and Circular A-133 Audits* dated February 1, 2014. Auditors conducted tests of compliance and of controls identified for each direct and material compliance area and performed analytical procedures when

Finding Classifications

Control weaknesses are classified as either significant deficiencies or material weaknesses:

- A **significant deficiency** indicates control weaknesses, but those weaknesses would not likely result in material non-compliance.
- A **material weakness** indicates significant control weaknesses that could potentially result in material non-compliance with the compliance area.

Similarly, compliance findings are classified as either non-compliance or material non-compliance, where material non-compliance indicates a more serious reportable issue.

appropriate. Auditors assessed the reliability of data that the Board provided and determined that the data was sufficiently reliable for the purposes of expressing an opinion on compliance with the provisions of laws, regulations, and contracts or grants that have a direct and material effect on the programs identified above.

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Independent Auditor's Report

*State of Texas Compliance with
Federal Requirements for
Selected Major Programs at the
Water Development Board
for the Fiscal Year Ended
August 31, 2014*

Report on Compliance for the Capitalization Grants for Clean Water State Revolving Funds Program and the Capitalization Grants for Drinking Water State Revolving Funds Program, and Report on Internal Control Over Compliance Required by OMB Circular A-133

Independent Auditor's Report

The Honorable Greg Abbott, Governor
The Honorable Dan Patrick, Lieutenant Governor
The Honorable Joe Straus III, Speaker of the House of Representatives
and
Members of the Legislature, State of Texas

Report on Compliance for the Capitalization Grants for Clean Water State Revolving Funds Program and the Capitalization Grants for Drinking Water State Revolving Funds Program

We have audited the State of Texas's (State) compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on the Capitalization Grants for Clean Water State Revolving Funds Program and the Capitalization Grants for Drinking Water State Revolving Funds Program for the year ended August 31, 2014. The State's major federal programs at the Water Development Board are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance on the State's compliance for the Capitalization Grants for Clean Water State Revolving Funds Program and the Capitalization Grants for Drinking Water State Revolving Funds Program based on our audit of the types of compliance requirements referred to above. 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 above that could have a direct and material effect on the Capitalization Grants for Clean Water State Revolving Funds Program and the Capitalization Grants for Drinking Water State Revolving Funds Program occurred. An audit includes examining, on a test basis, evidence about the State's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

This audit was conducted as part of the State of Texas Statewide Single Audit for the year ended August 31, 2014. As such, the Capitalization Grants for Clean Water State Revolving Funds Program and the Capitalization Grants for Drinking Water State Revolving Funds Program were selected as major programs based on the State of Texas as a whole for the year ended August 31, 2014. The State does not meet the OMB Circular A-133 requirements for a program-specific audit and the presentation of the Schedule of Federal Program Expenditures does not conform to the OMB Circular A-133 Schedule of Expenditures of Federal Awards. However, this audit was designed to be relied on for the State of Texas opinion on federal compliance, and in our judgment, the audit and this report satisfy the intent of those requirements.

We believe that our audit provides a reasonable basis for our opinion on compliance for the Capitalization Grants for Clean Water State Revolving Funds Program and the Capitalization Grants for Drinking Water State Revolving Funds Program. However, our audit does not provide a legal determination of the State's Compliance.

Opinion on the Capitalization Grants for Clean Water State Revolving Funds Program and the Capitalization Grants for Drinking Water State Revolving Funds Program

In our opinion, the State complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on the Capitalization Grants for Clean Water State Revolving Funds Program and the Capitalization Grants for Drinking Water State Revolving Funds Program for the year ended August 31, 2014.

Report on Internal Control Over Compliance

Management of the State is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the State's internal control over compliance with the types of requirements that could have a direct and material effect on the Capitalization Grants for Clean Water State Revolving Funds Program and the Capitalization Grants for Drinking Water State Revolving Funds Program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for the Capitalization Grants for Clean Water State Revolving Funds Program and the Capitalization Grants for Drinking Water State Revolving Funds Program 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 State's internal control over compliance.

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 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. *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.

Our consideration of internal control over compliance 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 compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

Schedule of Federal Program Expenditures

The accompanying Schedule of Federal Program Expenditures for the Capitalization Grants for Clean Water State Revolving Funds Program and the Capitalization Grants for Drinking Water State Revolving Funds Program of the State for the year ended August 31, 2014, is presented for purposes of additional analysis. This information is the responsibility of the State's management and has been subjected only to limited auditing procedures and, accordingly, we express no opinion on it. However, we have audited the Statewide Schedule of Expenditures of Federal Awards in a separate audit, and the opinion on the Statewide Schedule of Expenditures of Federal Awards is included in the *State of Texas Federal Portion of the Statewide Single Audit Report for the Fiscal Year Ended August 31, 2014*.

John Keel, CPA
State Auditor

February 20, 2015

**Schedule of Federal Program Expenditures for
the Capitalization Grants for Clean Water State Revolving Funds Program and
the Capitalization Grants for Drinking Water State Revolving Funds Program
For the State of Texas
For the Year Ended August 31, 2014**

Schedule of Federal Program Expenditures CFDA 66.458 - Capitalization Grants for Clean Water State Revolving Funds Program			
Agency	Federal Pass-through to Non-state Entity	Federal Direct Expenditures	Totals
Water Development Board			
Other than American Recovery and Reinvestment Act	\$155,934,868	\$3,736,086	\$159,670,954
American Recovery and Reinvestment Act	0	0	0
Total for Clean Water State Revolving Funds Program	\$155,934,868	\$3,736,086	\$159,670,954
<p>Note 1: This schedule of federal program expenditures is presented for informational purposes only. For the State's complete Schedule of Expenditures of Federal Awards, see the <i>State of Texas Federal Portion of the Statewide Single Audit Report for the Fiscal Year Ended August 31, 2014</i>.</p> <p>Note 2: Federal expenditures for the Capitalization Grants for Clean Water State Revolving Funds Program at state entities not included in the scope of this audit totaled \$123,938 for the year ended August 31, 2014.</p>			

Schedule of Federal Program Expenditures CFDA 66.468 - Capitalization Grants for Drinking Water State Revolving Funds Program			
Agency	Federal Pass-through to Non-state Entity	Federal Direct Expenditures	Totals
Water Development Board			
Other than American Recovery and Reinvestment Act	\$75,856,347	\$2,818,561	\$78,674,908
American Recovery and Reinvestment Act	0	0	0
Total for Drinking Water State Revolving Funds Program	\$75,856,347	\$2,818,561	\$78,674,908
<p>Note 1: This schedule of federal program expenditures is presented for informational purposes only. For the State's complete Schedule of Expenditures of Federal Awards, see the <i>State of Texas Federal Portion of the Statewide Single Audit Report for the Fiscal Year Ended August 31, 2014</i>.</p> <p>Note 2: Federal expenditures for the Capitalization Grants for Drinking Water State Revolving Funds Program at state entities not included in the scope of this audit totaled \$5,770,701 for the year ended August 31, 2014.</p>			

Schedule of Findings and Questioned Costs

*State of Texas Compliance with
Federal Requirements for
Selected Major Programs at the
Water Development Board
for the Fiscal Year Ended
August 31, 2014*

Summary of Auditor's Results

Financial Statements

Issued under separate cover. See State Auditor's Office report entitled *State of Texas Financial Portion of the Statewide Single Audit Report for the Year Ended August 31, 2014*.

Federal Awards

Internal Control over major programs:

Material weakness(es) identified? No

Significant deficiency(ies) identified? No

Type of auditor's report issued on compliance for major programs: See below.

Unmodified

Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of OMB Circular A-133? No

Identification of major programs:

CFDA Number	Name of Federal Program or Cluster
66.458	Capitalization Grants for Clean Water State Revolving Funds
66.468	Capitalization Grants for Drinking Water State Revolving Funds

Dollar threshold used to distinguish between type A
and type B programs: \$73,923,376

Auditee qualified as low-risk auditee? No

Section 2:

Financial Statement Findings

Issued under separate cover. See State Auditor's Office report entitled *State of Texas Financial Portion of the Statewide Single Audit Report for the Year Ended August 31, 2014*.

Section 3:

Federal Award Findings and Questioned Costs

This section identifies significant deficiencies, material weaknesses, and instances of non-compliance, including questioned costs, as required to be reported by Office of Management and Budget Circular A-133, Section 510(a).

Auditors did not identify any reportable findings at the Water Development Board for the fiscal year ended August 31, 2014.

Summary Schedule of Prior Year Audit Findings

Federal regulations (OMB Circular A-133) state, “the auditee is responsible for follow-up and corrective action on all audit findings.” As part of this responsibility, the auditee reports the corrective action it has taken for the following:

- Each finding in the 2013 Schedule of Findings and Questioned Costs.
- Each finding in the 2013 Summary Schedule of Prior Audit Findings that was not identified as implemented or reissued as a current year finding.

The Summary Schedule of Prior Audit Findings (year ended August 31, 2014) has been prepared to address these responsibilities.

Water Development Board

Reference No. 2013-195

Allowable Costs/Cost Principles

CFDA 66.458 - Capitalization Grants for Clean Water State Revolving Funds

CFDA 66.458 - Capitalization Grants for Clean Water State Revolving Funds - ARRA

Award years - October 1, 2008 to August 31, 2014; June 6, 2011 to August 31, 2015; and September 5, 2012 to August 31, 2016

Award numbers - 2W-96692401 (ARRA), CS-48000211, and CS-48000212

CFDA 66.468 - Capitalization Grants for Drinking Water State Revolving Funds

CFDA 66.468 - Capitalization Grants for Drinking Water State Revolving Funds - ARRA

Award years - February 1, 2009 to August 31, 2014; January 1, 2008 to December 31, 2014; September 1, 2008 to August 31, 2014; September 1, 2010 to August 31, 2015; September 1, 2011 to August 31, 2016; and September 1, 2012 to August 31, 2016

Award numbers - 2F-96692301 (ARRA), FS-99679511, FS-99679512, FS-99679514, FS-99679515, and FS-99679516

Type of finding - Significant Deficiency

Entities shall maintain internal control over federal programs that provides reasonable assurance that they are managing federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements (Office of Management and Budget Circular A-133, Subpart C, Section 300 (b)).

The Water Development Board (Board) did not maintain adequate user access controls over its Labor Distribution system. Specifically, one employee had access rights as a high-level system administrator and as a system programmer, and that employee also had the ability to move programming changes into the production environment of the Labor Distribution system. A lack of segregation of duties in system access and allowing programmers to migrate code to the production environment increases the risk of inappropriate changes to systems.

Initial Year Written: 2013
Status: Implemented

U.S. Environmental Protection
Agency

Corrective Action:

Corrective action was taken.

WATER DEVELOPMENT BOARD

Reference No. 2013-196

Subrecipient Monitoring

CFDA 66.458 - Capitalization Grants for Clean Water State Revolving Funds

Award year - September 5, 2012 to August 31, 2016

Award number - CS-48000212

Type of finding - Significant Deficiency and Non-Compliance

The Water Development Board (Board) is required by Office of Management and Budget (OMB) Circular A-133, Section 400(d), to identify to the subrecipient, at the time of the subaward, the federal award information, including the Catalog of Federal Domestic Assistance (CFDA) title and number, award name and number, whether the award is research and development, name of federal awarding agency, and applicable compliance requirements.

Initial Year Written: 2013 Status: Implemented

U.S. Environmental Protection Agency

For 1 (13 percent) of 8 subrecipients tested, the Board communicated an incorrect CFDA title and number to the subrecipient at the time of the subaward commitment. The Board provided documentation that it correctly identified the project in its internal documentation, but it could not provide evidence that it communicated the correct CFDA title and number to the subrecipient. Inadequate identification of federal awards could lead to improper reporting of federal funding on a subrecipient's schedule of expenditures of federal awards.

Corrective Action:

Corrective action was taken.

Appendix

Objectives, Scope, and Methodology

Objectives

With respect to the Capitalization Grants for Clean Water State Revolving Funds Program (Clean Water Program) and the Capitalization Grants for Drinking Water State Revolving Funds Program (Drinking Water Program), the objectives of this audit were to (1) obtain an understanding of internal controls over compliance, assess control risk of noncompliance, and perform tests of those controls unless the controls were deemed to be ineffective and (2) provide an opinion on whether the State complied with the provisions of laws, regulations, and contracts or grants that have a direct and material effect on those programs.

Scope

The audit scope covered federal funds that the State spent for the Clean Water Program and the Drinking Water Program at the Water Development Board (Board) from September 1, 2013, through August 31, 2014. The audit work included control and compliance tests at the Board.

Methodology

The audit methodology included developing an understanding of controls over each compliance area that was direct and material to the Clean Water Program and the Drinking Water Program.

Auditors selected non-statistical samples for tests of compliance and controls for each direct and material compliance area based on the American Institute of Certified Public Accountants' audit guide entitled *Government Auditing Standards and Circular A-133 Audits* dated February 1, 2014. In determining sample sizes for control and compliance test work, auditors assessed risk levels for inherent risk of noncompliance, control risk of noncompliance, risk of material noncompliance, detection risk, and audit risk of noncompliance by compliance requirement. Auditors selected samples primarily through random selection designed to be representative of the population. In those cases, results may be extrapolated to the population, but the accuracy of the extrapolation cannot be measured. In some cases, auditors used professional judgment to select additional items for compliance testing. Those sample items generally are not representative of the population and, therefore, it would be inappropriate to extrapolate those results to the population.

Auditors conducted tests of compliance and of controls identified for each direct and material compliance area and performed analytical procedures when appropriate.

Auditors assessed the reliability of data that the Board provided and determined that the data was sufficiently reliable for the purposes of expressing an opinion on compliance with the provisions of laws, regulations, and contracts or grants that have a direct and material effect on the Clean Water Program and the Drinking Water Program.

Information collected and reviewed included the following:

- Board data for expenditures, procurement, reporting, cash revenue, required matching funds, program income, and subrecipients.
- Federal notices of award and award proposals.
- Transactional support related to expenditures, procurement, and revenues.
- Board-generated reports and data used to support reports, revenues, and other compliance areas.
- Information system support related to general controls over information systems that affect the control structure related to federal compliance.

Procedures and tests conducted included the following:

- Analytical procedures performed on expenditure data to identify instances of non-compliance.
- Compliance testing for samples of transactions for each direct and material compliance area.
- Tests of design and effectiveness of key controls and tests of design of other controls to assess the sufficiency of the Board's control structure.
- Tests of design and effectiveness of general controls over information systems that support the control structure related to federal compliance.

Criteria used included the following:

- The Code of Federal Regulations.
- United States Code.
- U.S. Office of Management and Budget Circulars A-87, A-102, and A-133.
- The Federal Funding Accountability and Transparency Act.

- Federal notices of award and award proposals.
- Federal agency circulars, handbooks, and guidance.
- Board policies and procedures.

Project Information

Audit fieldwork was conducted from August 2014 through December 2014. Except as discussed above in the Independent Auditor's Report, 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 Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

The following members of the State Auditor's staff performed the audit:

- Jennifer Brantley, MS, CPA (Project Manager)
- Parsons Dent Townsend, CGAP, CICA (Assistant Project Manager)
- Serra Tamur, MPAff, CIA, CISA (Information Technology Coordinator)
- Karen S. Mullen, CGAP (Prior Year Finding Coordinator)
- Isaac Barajas
- John Barnhart
- Adam Berry
- J. Scott Killingsworth, CIA, CGAP, CGFM (Quality Control Reviewer)
- Dana Musgrave, MBA (Quality Control Reviewer)
- James Timberlake, CIA (Audit Manager)

Copies of this report have been distributed to the following:

Legislative Audit Committee

The Honorable Dan Patrick, Lieutenant Governor, Joint Chair
The Honorable Joe Straus III, Speaker of the House, Joint Chair
The Honorable Jane Nelson, Senate Finance Committee
The Honorable Robert Nichols, Member, Texas Senate
The Honorable John Otto, House Appropriations Committee
The Honorable Dennis Bonnen, House Ways and Means Committee

Office of the Governor

The Honorable Greg Abbott, Governor

Water Development Board

Members of the Water Development Board
Mr. Carlos Rubinstein, Chairman
Mr. Bech Bruun
Ms. Kathleen Jackson
Mr. Kevin Patteson, Executive Administrator



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