



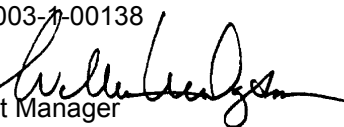
**ENVIRONMENTAL PROTECTION AGENCY**  
WASHINGTON, D.C

OFFICE OF  
INSPECTOR GENERAL

September 17, 2003

Memorandum

Subject: Auditor's Report for the South Carolina Drinking Water State Revolving Fund Program (the Program) as of June 30, 2002  
Audit Report No.2003-1-00138

From: William M. Dayton   
National SRF Audit Manager

To: Jimmy Palmer  
Regional Administrator  
EPA, Region 4  
Atlanta, GA

Attached is a copy of the subject audit we sent to the State of South Carolina. The audit contains reports on the financial statements, internal controls, and compliance requirements applicable to the Drinking Water State Revolving Fund (SRF) program in South Carolina for the year ended June 30, 2002.

We issued an unqualified opinion on the financial statements and did not note any matters involving the internal control system and operations that we consider to be reportable conditions. We qualified our opinion on the compliance requirements applicable to the SRF program because the South Carolina Drinking Water State Revolving Fund did not comply with certain compliance matters required by the Safe Drinking Water Act and regulations. In response to the draft audit report, management agreed with our compliance issue, and is taking appropriate steps to correct the deficiency.

In accordance with EPA directive 2750, the Action Official is required to take action on the findings and recommendations in this report within 150 days.

The OIG has no objection to the release of this report to any member of the public upon request. The report contains no confidential business or proprietary information.

If you have any questions or concerns regarding this matter, please feel free to contact me at (916) 498-6590 or Mr. Paul Felz at (303) 312-6270.

Attachment



**ENVIRONMENTAL PROTECTION AGENCY**  
WASHINGTON, D.C

OFFICE OF  
INSPECTOR GENERAL

September 17, 2003

Mr. R. Lewis Shaw, Deputy Commissioner  
South Carolina Department of Health and Environmental Control

Mr. Michael S. Gulledge, Director  
Office of Local Government  
South Carolina State Budget and Control Board

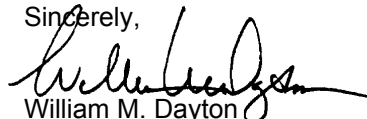
Re: Audit Reports of the Financial Statements of the South Carolina Drinking Water State Revolving  
Fund Program for the year ended June 30, 2002  
Audit Report No. 2003-1-00138

Dear Mr. Shaw and Mr. Gulledge:

Enclosed please find an electronic copy of the audited financial statements for the South Carolina Drinking Water State Revolving Fund Program for the year ended June 30, 2002. We made certain adjustments and reclassifications, to which you have agreed, in order to have the financial statements follow EPA's current reporting guidelines, which are in accordance with generally accepted accounting principles

We would like to thank you and your staff for the cooperation and courtesies we received during our audit. Please feel free to call me at (916) 498-6590 or Mr. Paul Felz at (303) 312-6270 should you have any comments or questions.

Sincerely,

  
William M. Dayton  
National SRF Audit Manager



**OIG**

OFFICE OF INSPECTOR GENERAL

*Catalyst for Improving the Environment*

## **Audit Report**

# **South Carolina Drinking Water State Revolving Fund Program**

**Financial Statements with  
Independent Auditor's Report, June 30, 2002**

**Audit Report Number 2003-1-00138**

**Issued September 17, 2003**

**South Carolina Drinking Water State Revolving Fund  
Table of Contents**

Independent Auditor’s Report.....	1
Balance Sheet .....	2
Statement of Revenues, Expenses, and Changes in Fund Equity .....	3
Statement of Cash Flows .....	4
Notes to Financial Statements.....	5
Independent Auditor’s Report on the Internal Control Structure Based on an Audit of the Financial Statements Performed in Accordance with Government Auditing Standards .....	11
Independent Auditor’s Report on Compliance with Requirements Applicable to the Environmental Protection Agency’s State Revolving Fund Program in Accordance with Government Auditing Standards .....	13
Supplemental Information.....	16



**ENVIRONMENTAL PROTECTION AGENCY**  
WASHINGTON, D.C

OFFICE OF  
INSPECTOR GENERAL

Independent Auditor's Report

To: Mr. R. Lewis Shaw, Deputy Commissioner  
South Carolina Department of Health and Environmental Control

Mr. Michael S. Gullledge, Director  
Office of Local Government  
South Carolina State Budget and Control Board

We have audited the accompanying balance sheet of the South Carolina Drinking Water State Revolving Fund Program (the Program) as of June 30, 2002, the related statement of revenues, expenses, and changes in fund equity, and the statement of cash flows for the year then ended. These financial statements are the responsibility of the Program's management. Our responsibility is to express an opinion on these financial statements based on our audit.


We conducted our audit in accordance with generally accepted auditing standards in the United States of America and *Government Auditing Standards* issued by the Comptroller General of the United States of America. 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 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.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Program as of June 30, 2002, and the results of its activities and its cash flows for the year then ended in conformity with generally accepted accounting principles in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The supplemental information is presented for purposes of additional analysis of the financial statements. The supplemental 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.

As discussed in Note 1, the financial statements referred to above are intended to present the financial position and results of operations of the Program, a component of the general fund of the State of South Carolina. These statements are not intended to present the financial position or results of operations for the State of South Carolina, the South Carolina Department of Health and Environmental Control, or the South Carolina State Budget and Control Board, of which the Program is a part. Certain supplementary information referred to as Management Discussion and Analysis, although not a required part of the basic financial statements, has been omitted for this program-specific financial presentation.

In accordance with *Government Auditing Standards*, we have also issued a report dated April 25, 2003, on our consideration of the Program's internal control structure and a report dated April 25, 2003, on the Program's compliance with laws and regulations.

  
Office of Inspector General  
April 25, 2003

**SOUTH CAROLINA**  
**Drinking Water State Revolving Fund (DWSRF)**  
**Combining Balance Sheet**  
**June 30, 2002**  
*(With comparative unaudited totals for 2001)*

	<u>DWSRF</u>	<u>Loan Fee</u>	<u>(Memorandum only) Total 2002</u>	<u>(Unaudited) 2001</u>
<b>Assets:</b>				
Current assets:				
Cash and cash equivalents	\$ 9,547,150	\$ 383,506	\$ 9,930,656	\$ 7,517,243
Loan interest receivable	130,682	-	130,682	168,840
Investment interest receivable	113,746	-	113,746	62,536
Federal grant receivable	23,428	-	23,428	33,372
Current portion of loans receivable	948,344	-	948,344	767,293
Total current assets	<u>10,763,350</u>	<u>383,506</u>	<u>11,146,856</u>	<u>8,549,284</u>
Noncurrent assets:				
Loans receivable, net of current portion	23,719,842	-	23,719,842	21,087,852
Total noncurrent assets	<u>23,719,842</u>	<u>-</u>	<u>23,719,842</u>	<u>21,087,852</u>
 Total assets	 <u>\$ 34,483,192</u>	 <u>\$ 383,506</u>	 <u>\$ 34,866,698</u>	 <u>\$ 29,637,136</u>
 <b>Liabilities and Fund Equity:</b>				
Current liabilities:				
Unearned income	25,659	-	25,659	14,221
Due to other funds	23,428	-	23,428	33,372
Total current liabilities	<u>49,087</u>	<u>-</u>	<u>49,087</u>	<u>47,593</u>
 Fund Equity	 <u>34,434,105</u>	 <u>383,506</u>	 <u>34,817,611</u>	 <u>29,589,543</u>
 Total liabilities and fund equity	 <u>\$ 34,483,192</u>	 <u>\$ 383,506</u>	 <u>\$ 34,866,698</u>	 <u>\$ 29,637,136</u>

**SOUTH CAROLINA**  
**Drinking Water State Revolving Fund**  
**Combining Statement of Revenues, Expenses**  
**and Changes in Fund Equity**  
**For the year ended June 30, 2002**  
*(With comparative unaudited totals for 2001)*

	<b>DWSRF</b>	<b>Loan Fee</b>	<b>(Memorandum only) Total 2002</b>	<b>Unaudited 2001</b>
<b>Revenues:</b>				
Loan interest	\$ 903,783		\$ 903,783	\$ 720,345
Investment earnings	413,166	\$ 15,416	428,582	267,780
Grant Revenues	1,384,743	-	1,384,743	542,447
Management fees	-	123,501	123,501	5,097
Total revenues	<u>2,701,692</u>	<u>138,917</u>	<u>2,840,609</u>	<u>1,535,669</u>
<b>Expenses:</b>				
Salaries and benefits	335,618	62,329	397,947	297,385
Contractual services	973,647	2,412	976,059	245,039
Travel	5,394	-	5,394	-
Indirect costs	30,242	-	30,242	21,098
Other operating costs	39,842	3,949	43,791	41,531
Total expenses	<u>1,384,743</u>	<u>68,690</u>	<u>1,453,433</u>	<u>605,053</u>
Operating income	<u>1,316,949</u>	<u>70,227</u>	<u>1,387,176</u>	<u>930,616</u>
<b>Capital Contributions</b>				
Environmental Protection Agency	2,781,762	-	2,781,762	8,954,925
State of South Carolina	1,059,130	-	1,059,130	4,626,817
Total Capital Contributions	<u>3,840,892</u>	<u>-</u>	<u>3,840,892</u>	<u>13,581,742</u>
Change in net assets	5,157,841	70,227	5,228,068	14,512,358
Fund equity, beginning of year	<u>29,276,264</u>	<u>313,279</u>	<u>29,589,543</u>	<u>15,077,185</u>
Fund equity, end of year	<u>\$ 34,434,105</u>	<u>\$ 383,506</u>	<u>\$ 34,817,611</u>	<u>\$ 29,589,543</u>

**SOUTH CAROLINA**  
**Drinking Water State Revolving Fund**  
**Statement of Cash Flows**  
**For the year ended June 30, 2002**  
*(With comparative unaudited totals for 2001)*

	<b>2002</b>	<b>(Unaudited) 2001</b>
	<u>2002</u>	<u>2001</u>
Cash provided (used) by operating activities:		
Loan interest	\$ 941,941	\$ 601,560
Loan fees	123,501	5,097
Investment interest	377,372	230,531
Operating grants	1,395,776	528,500
Program administration	(310,715)	(284,516)
Technical assistance	(164,074)	(158,163)
State drinking water program management	(32,089)	-
Local assistance	(946,150)	(136,348)
Loan disbursements	(3,580,334)	(11,002,721)
Loan repayments	767,293	575,490
Net cash provided (used) by operating activities	<u>(1,427,479)</u>	<u>(9,640,570)</u>
Cash flows from capital and related financing activities:		
Capital Funds received from EPA	2,781,762	8,954,925
State match	1,059,130	4,626,817
Net cash used in capital and related financing activities:	<u>3,840,892</u>	<u>13,581,742</u>
Increase (decrease) in cash and cash equivalents	2,413,413	3,941,172
Cash and cash equivalents, beginning of year	7,517,243	3,576,071
Cash and cash equivalents, end of year	<u>\$ 9,930,656</u>	<u>\$ 7,517,243</u>
Reconciliation of net operating income to net cash provided (used) by operating activities:		
Net operating income	\$ 1,387,175	930,616
Adjustments to reconcile operating income to net cash provided by operating activities:		
(Increase) decrease in current receivables	(3,109)	(182,059)
Increase (decrease) in current liabilities	1,495	38,104
Loan disbursements	(3,580,334)	(11,002,721)
Loan repayments	767,293	575,490
Net cash provided by operating activities	<u>\$ (1,427,479)</u>	<u>\$ (9,640,570)</u>



**SOUTH CAROLINA**  
**Drinking Water State Revolving Fund**  
**Notes to Financial Statements**

**1. Organization of the Program**

The South Carolina Drinking Water State Revolving Fund Program was established pursuant to section 1452 (a) of the Safe Drinking Water Act amendments of 1996 and Section 48-5-55 of the South Carolina Code of Laws. The purpose of the DWSRF is to provide low interest loans to public water systems for construction of drinking water facilities. Projects are normally funded for a maximum term of twenty years; however, loan applicants considered to be disadvantaged communities may be offered loans with a maximum term of thirty years. Interest rates, which are established annually by the Budget and Control Board, are typically 30% to 33% below the average Bondbuyer 25 index. All loan repayments and interest are deposited back in the Program to fund additional projects.

The State of South Carolina's Department of Health and Environmental Control (DHEC) and the South Carolina Budget and Control Board, Office of Local Government (OLG) have entered into a Memorandum of Agreement under which each has agreed to assume specified responsibilities in connection with operations of the Program. DHEC develops an annual Intended Use Plan, maintains a project priority system, obtains capitalization grants from the U.S. Environmental Protection Agency (EPA), performs technical project reviews, monitors construction, and is responsible for the environmental and technical aspects of the Program. DHEC also sets aside portions of the capitalization grants allowed by the Safe Drinking Water Act to fund certain other drinking water related activities, including administration of the DWSRF, the State's drinking water program administration and management, source water protection, operator certification, capacity development and technical assistance for small water systems.

The OLG establishes the financial policies governing loans, makes final loan decisions, disburses funds to borrowers, manages and accounts for the loan funds, and ensures the state match is timely deposited.

DHEC's cost of administering the DWSRF program is charged to the four percent administrative set-aside. The OLG's administration costs are charged to the Management Fee Fund. Administration costs include the salaries and benefits of the employees, as well as indirect costs allocated to the Program. Employees charging time to the Program are covered by the benefits available to State of South Carolina employees. The fund is also charged indirect costs through a cost allocation plan agreement between DHEC and the EPA, which is renewed annually.

The Program's financial statements, footnotes, and related schedules are presented for the EPA. The Program is included in the State of South Carolina's basic financial statements as a part of a special revenue fund, which uses the modified accrual basis of accounting. Due to differences in reporting methods, there may be differences between the amounts reported in these financial statements and the State's basic financial statements.

**2. Summary of Significant Accounting Policies**

***Basis of Accounting***

The financial statements for the Program are presented as an enterprise fund. As such, the Program is accounted for using the flow of economic resources measurement focus and is maintained on the accrual method of accounting. Under the accrual method of accounting, revenues are recognized when earned and expenses are recorded at the time the liabilities

**SOUTH CAROLINA**  
**Drinking Water State Revolving Fund**  
**Notes to Financial Statements**

**2. Summary of Significant Accounting Policies (continued)**

are incurred. All assets and liabilities associated with the operations of the Program are included on the balance sheet. The State has elected to follow the accounting pronouncements of the Governmental Accounting Standards Board, as well as statements issued by the Financial Accounting Standards Board on or before November 30, 1989, unless the pronouncements conflict with or contradict GASB pronouncements.

***Cash and Cash Equivalents***

All monies of the loan fund are deposited with the South Carolina State Treasurer's Office, which is responsible for maintaining these deposits in accordance with South Carolina State law. The Program considers all such deposits to be cash. The Program on a monthly basis receives investment interest earnings on these deposits. According to State law, the Treasurer is responsible for maintaining the cash balances and investing excess cash of the Program, as further discussed in Note 3. Consequently, management of the Program does not have any control over the investment of the excess cash. The statement of cash flows considers all funds deposited with the Treasurer to be cash or cash equivalents, regardless of actual maturities of the underlying investments.

Cash received by DHEC from EPA to fund "set-aside" activities are generally used immediately to reimburse other funds for eligible expenditures. Occasionally, DHEC will draw funds based on future estimated expenditures, resulting in small cash balances, held by DHEC, that are used to reimburse other funds when the expenditures are incurred.

***Loans Receivable***

Loans are funded by Federal capitalization grants and State matching funds. The DWSRF monies are disbursed to borrowers on a cost reimbursement basis. When the borrowers have incurred qualifying expenses, they request a loan disbursement from the Program, and, upon approval, a disbursement is made. Interest begins accruing when funds are disbursed to the borrower. Repayment of the loan begins within three to nine months after a Permit to Operate is projected to be issued by DHEC, or up to 30 months after the loan is made, whichever occurs first. The loans generally have maturities up to 20 years. South Carolina provides longer repayment terms and/or interest subsidies for disadvantaged communities under the Disadvantaged System Program as outlined in the State's Intended Use Plan.

There is no allowance for uncollectible accounts, as all repayments are current, and management believes all loans will be repaid according to the loan terms.

***Contributed Capital***

In accordance with generally accepted accounting principles, funds received from EPA and the State of South Carolina to capitalize the loan program are recorded as other revenues. Funds received from EPA for reimbursement of set-aside expenses are treated as operating grants.

**SOUTH CAROLINA**  
**Drinking Water State Revolving Fund**  
**Notes to Financial Statements**

**3. Cash and Cash Equivalents**

All cash in the Program is deposited with the State Treasurer who is responsible for maintaining and investing the pooled cash balances in accordance with State laws. The Treasurer is required to maintain a mix of investments in order to allow funds to be withdrawn at any time to meet normal operating needs. The Program's share of the investment income from the local government investment pool is based on the average daily balance for the period and is credited to the Program monthly. Details of the investments can be obtained from the State Treasurer's Office.

All cash and investments in the local government investment pool are stated at cost, which approximates fair market value. Investments in local government investment pools are not categorized because they are not evidenced by securities that exist in physical or book entry form.

	<u>Carrying Amount</u>
Not subject to categorization:	
Local government investment pool	<u>\$ 9,930,656</u>

**4. Loans Receivable**

The Program makes loans to qualified entities at interest rates ranging from 3.5 percent to 4.0 percent with scheduled final maturity dates through 2032.

Loans receivable activity during the year ended June 30, 2002 is summarized as follows:

Loan Status	Loan Amount Authorized	Remaining Commitment	Loan Balance June 30, 2001	Disbursements	Repayments	Loan Balance June 30, 2002
Funding Completed	\$ 12,034,928	\$ -	\$ 11,354,599	\$ 13,666	\$ (469,613)	\$ 10,898,652
Funding in Progress	22,351,208	8,138,434	10,500,546	3,566,668	(297,680)	13,769,534
Total	\$ 34,386,136	\$ 8,138,434	\$ 21,855,145	\$ 3,580,334	\$ (767,293)	\$ 24,668,186

The Program has entered into nine loans to three local communities that represented 91 percent of the total loans outstanding at June 30, 2002, as follows:

Community	Loan Authorized	Loan Outstanding	Percentage of Total Outstanding
Beaufort-Jasper Water and Sewer Authority	\$ 16,409,116	\$ 9,993,024	41%
City of Florence	8,978,340	8,694,520	35%
Startex-Jackson-W ellford-Duncan Water District	4,793,309	3,813,089	15%
Total	\$ 30,180,765	\$ 22,500,633	91%

**SOUTH CAROLINA**  
**Drinking Water State Revolving Fund**  
**Notes to Financial Statements**

**4. Loans Receivable (continued)**

Loans mature at various intervals through January, 2032. The scheduled principal and interest payments on completely disbursed loans maturing in the next five years and every five years thereafter are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2003	\$ 488,192	\$ 404,081	\$ 892,272
2004	506,960	385,312	892,272
2005	526,453	365,820	892,272
2006	546,698	345,574	892,272
2007	567,726	324,546	892,272
2008-2012	2,951,781	1,289,117	4,240,899
2013-2017	3,353,147	707,373	4,060,520
2018-2020	1,957,696	104,213	2,061,909
Totals	<u>\$10,898,652</u>	<u>\$ 3,926,036</u>	<u>\$14,824,688</u>

The current portion of loans receivable includes \$488,192 for completed projects and an estimated \$460,152 for projects that are still in progress, for a total of \$948,344. The amortization schedules for the projects in progress may change upon completion of the project when the final loan balance will be determined.

**5. Fund Equity**

The Program is capitalized by grants through EPA and state match provided by the State of South Carolina equaling 20 percent of the federal capitalization amount. The EPA grants and the State match are included in the fund equity balance. South Carolina's matching contribution has been provided through appropriation of State general fund resources. As of June 30, 2002, EPA has awarded \$44,515,247 to the state, of which \$23,959,533 has been drawn for loans and set-aside expenses. The State has provided match funds of \$10,513,550. The following summarizes the capitalization grant award, amounts drawn on each grant as of the balance sheet date, and balances available for future loans and set-aside costs:

<u>Grant</u>	<u>Grant Amount</u>	<u>Total Draws as of June 30, 2001</u>	<u>2002 Draws</u>	<u>Total Draws as of June 30, 2002</u>	<u>Grant Funds Available June 30, 2002</u>
FS984312-97	\$ 14,821,600	\$ 13,638,844	\$1,117,000	\$ 14,755,844	\$ 65,756
FS984312-98	7,669,400	6,143,151	1,361,060	7,504,211	165,189
FS984312-99	8,038,300	-	1,666,478	1,666,478	6,371,822
FS984312-00	5,597,247	-	2,000	2,000	5,595,247
FS984312-01	8,388,700	-	31,000	31,000	8,357,700
	<u>\$ 44,515,247</u>	<u>\$ 19,781,995</u>	<u>\$4,177,538</u>	<u>\$ 23,959,533</u>	<u>\$ 20,555,714</u>

The capitalization grant FS984312-00 was amended on June 21, 2002, and \$2,756,853 of the DWSRF was transferred to the Clean Water State Revolving Fund. The schedule above includes the amended grant amount.

**SOUTH CAROLINA  
Drinking Water State Revolving Fund  
Notes to Financial Statements**

**5. Fund Equity (continued)**

As of June 30, 2001 and 2002, State matching contributions were as follows:

	<u>June 30, 2001</u>	<u>Contributions</u>	<u>June 30, 2002</u>
South Carolina State Match	<u>\$ 9,454,420</u>	<u>\$ 1,059,130</u>	<u>\$ 10,513,550</u>

**6. Set-Aside Costs**

Total set-aside costs charged to the Program are as follows:

	<u>Administrative</u>	<u>Technical Assistance</u>	<u>State Program Management</u>	<u>Source Water Protection</u>	<u>Total Set-Aside</u>
FY 1998	\$ 122,874	\$ -	\$ -	\$ 50,156	\$ 173,030
FY 1999	289,604	-	-	170,800	460,405
FY 2000	249,575	6,103	-	120,792	376,470
FY 2001	247,935	158,163	-	136,348	542,447
FY 2002	242,431	164,074	32,089	946,150	1,384,743
Total	<u>\$ 1,152,419</u>	<u>\$ 328,340</u>	<u>\$ 32,089</u>	<u>\$ 1,424,246</u>	<u>\$ 2,937,094</u>

**7. Contingencies, Related Parties, and Subsequent Events**

***Contingencies***

The Program is exposed to various risks of loss related to torts, thefts of assets, errors or omissions, injuries to state employees while performing Program business, or acts of God. The State maintains insurance for all risks of loss, which is included in the indirect costs allocated to the Program.

According to DHEC management and legal counsel, there are no other loss contingencies which require disclosure or accrual under the Statement of Financial Accounting Standards No. 5.

***Related Parties***

There are no related party transactions with or related amounts receivable from management of the Programs.

***Subsequent Events***

On September 3, 2002, EPA awarded South Carolina a capitalization grant in the amount of \$8,052,500.

**Independent Auditor's Report on the  
South Carolina Drinking Water State Revolving Fund Program  
Internal Control Structure Based on an  
Audit of the Financial Statements  
Performed in Accordance with  
*Government Auditing Standards***



**ENVIRONMENTAL PROTECTION AGENCY**  
WASHINGTON, D.C

OFFICE OF  
INSPECTOR GENERAL

Mr. R. Lewis Shaw, Deputy Commissioner  
South Carolina Department of Health and Environmental Control

Mr. Michael S. Gullledge, Director  
Office of Local Government  
South Carolina State Budget and Control Board

We have audited the financial statements of the South Carolina Drinking Water State Revolving Fund Program (the Program) as of and for the year ended June 30, 2002, and have issued our report thereon dated April 25, 2003.

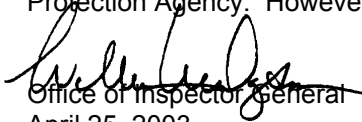
We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The management of the Program is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit of the financial statements of the Program for the year ended June 30, 2002, we obtained an understanding of the internal control structure. With respect to the internal control structure, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control structure. Accordingly, we do not express such an opinion.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more of the specific internal control elements does not reduce to a relatively low level the risk that errors and irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control structure and its operations that we consider to be material weaknesses as defined above.

This report is intended for the information of management of the Program and the U.S. Environmental Protection Agency. However, this report is a matter of public record and distribution is not limited.

  
Office of Inspector General  
April 25, 2003

**Independent Auditor's Report  
on Compliance with Requirements Applicable to the  
South Carolina Drinking Water State Revolving Fund Program  
in Accordance with  
*Government Auditing Standards***





**ENVIRONMENTAL PROTECTION AGENCY**  
WASHINGTON, D.C

OFFICE OF  
INSPECTOR GENERAL

Mr. R. Lewis Shaw, Deputy Commissioner  
South Carolina Department of Health and Environmental Control

Mr. Michael S. Gullledge, Director  
Office of Local Government  
South Carolina State Budget and Control Board

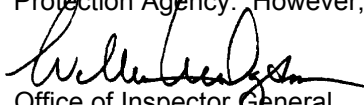
We have audited the financial statements of the South Carolina Drinking Water State Revolving Fund Program (the Program) as of and for the year ended June 30, 2002, and have issued our report thereon dated April 25, 2003.

We have also audited the Program's compliance with specific program requirements governing allowability for specific activities, allowable types of assistance, state matching, period of availability of funds and binding commitments, cash management, program income, and subrecipient monitoring that are applicable to the Program for the year ended June 30, 2002. The management of the Program is responsible for the Program's compliance with those requirements. Our responsibility is to express an opinion on those requirements based on our audit.

We conducted our audit of compliance in accordance with generally accepted auditing standards, *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 material noncompliance with the requirements referred to above occurred. An audit includes examining, on a test basis, evidence about the Program's compliance with those requirements. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, except for matters discussed in the Findings and Recommendations Section, the Program complied, in all material respects, with the specific program requirements that are applicable to the Program for the year ended June 30, 2002.

This report is intended for the information of management of the Program and the U.S. Environmental Protection Agency. However, this report is a matter of public record and its distribution is not limited.

  
Office of Inspector General  
April 25, 2003

## **Findings and Recommendations**

### **State Match**

As of June 30, 2002, the State was out of compliance with 40 CFR 35.3550 which requires States to provide a dollar for dollar match for expenditures made under the State program management set-aside. This match must be in the form of an eligible credit, funds deposited into the set-aside accounts, or documented in-kind services. According to 40 CFR 35.3535, the match is to be provided at the time of the capitalization grant award or in the same year that funds for this set-aside are expected to be expended in accordance with a workplan approved by EPA. The State is authorized to use the amount of State funds it expended on its Public Water System Supervision program in fiscal year 1993 as a credit up to, but not greater than, 50 percent of the amount of match required.

The State had charged \$32,089 expenditures to the State program management set-aside fund during 2002, and should have provided the same amount in state match funds. They had documented \$7,904 of in-kind services that were eligible for match. Including \$7,904 in credit available from the fiscal year 1993 funds expended, the total match provided was \$15,808, for a \$16,281 shortfall.

We recommend the State promptly deposit provide the \$16,281 match required for FY 2002 funds (50 percent of which can utilize the available credit from fiscal year 1993.) In future Intended Use Plans, the State should provide the source of this match, as required by 40 CFR 35.3535(d)(2)(i) and 40 CFR 35.3550(h). It should also provide information on how it met the match requirement in its biennial report to EPA.

### **State Response**

The State responded:

*The Department concurs with the findings . . . of the report for the DWSRF program regarding the timing of the match for the State program management set-aside fund. Since becoming aware of this requirement we have taken steps to insure the match is provided on a fiscal year basis. We anticipate covering the required match by the closure of the DWSRF Program Grant Agreement #FS981312-01-1, which is expected to be no later than September 30, 2006.*

### **OIG Response**

We appreciate the State recognizing the need to provide the match funds required. However, 40 CFR 35.3550 is an annual requirement, and the shortfall needs to be corrected as soon as possible. We see no reason for the State to be out of compliance until fiscal year end 2006 on this matter.

## **Supplemental Information**

**State of South Carolina**  
**Drinking Water State Revolving Fund**  
**Schedule of Set-aside Expenses**  
**Year Ended June 30, 2002**

<u>Cost Category</u>	<u>Administration</u>	<u>Program Management</u>	<u>Technical Assistance</u>	<u>Local Assistance</u>	<u>Total</u>
Salaries	\$ 153,739	\$ 20,356	\$ -	\$ 88,873	\$ 262,967
Fringe Benefits	42,825	5,219	-	24,607	72,651
Travel	3,806	1,252	-	336	5,394
Equipment	-	-	-	1,233	1,233
Supplies	249	-	-	8	257
Non Cap-Software	616	-	-	-	616
Contractual	1,454	-	164,074	808,120	973,647
Other Operating Costs	22,062	2,921	-	12,753	37,736
Total Direct Cost	<u>224,750</u>	<u>29,748</u>	<u>164,074</u>	<u>935,929</u>	<u>1,354,501</u>
Indirect Cost	17,680	2,341	-	10,220	30,241
Total Cost	<u>\$ 242,431</u>	<u>\$ 32,089</u>	<u>\$ 164,074</u>	<u>\$ 946,150</u>	<u>\$ 1,384,743</u>



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