

**MANAGEMENT LETTER
OF THE
NEBRASKA DEPARTMENT OF
ENVIRONMENTAL QUALITY
DRINKING WATER
STATE REVOLVING FUND PROGRAM
JULY 1, 2001 THROUGH JUNE 30, 2002**

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March 5, 2003

Kate Witek
State Auditor
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Mike Linder, Director
Nebraska Department of Environmental Quality
P.O. Box 98922
Lincoln, Nebraska 68509-8922

Deann Haeffner, CPA
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Dear Mr. Linder:

Don Dunlap, CPA
Asst. Deputy Auditor
ddunlap@mail.state.ne.us

We have audited the financial statements of the Nebraska Department of Environmental Quality (Department) – Drinking Water State Revolving Fund Program (Program) as of and for the year ended June 30, 2002, and have issued our report thereon dated March 5, 2003. We have also issued a Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*, dated March 5, 2003 and a Report on Compliance with Requirements Applicable to the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program in Accordance with *U.S. Environmental Protection Agency Audit Guide for Clean Water and Drinking Water State Revolving Fund Programs*.

Pat Reding, CPA
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In planning and performing our audit, we considered the Program's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting, and on the Program's compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts.

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We noted certain matters involving the internal control over financial reporting and other operational matters that are presented here. Comments and recommendations are intended to improve the internal control over financial reporting, ensure compliance, or result in operational efficiencies.

Robert Hotz, JD
Legal Counsel
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Our Comments and Recommendations for the Program for the fiscal year ended June 30, 2002 are included on pages 4-6.

This letter is intended solely for the information and use of the Department, the appropriate Federal and regulatory agencies, and citizens of the State of Nebraska, and is not intended to be and should not be used by anyone other than these specified parties.

Sincerely,

Pat Reding, CPA

Pat Reding
Assistant Deputy Auditor

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

SUMMARY OF COMMENTS

1. **Cash Reconciliation:** The cash and cash equivalents as recorded on the Nebraska Accounting System (NAS) were \$26,169 more than were reported on the financial statements. This amount is nearly double the variance of the prior year.
2. **Loan Records:** The Department accounted for loans using both internal records and NAS, instead of using NAS only.
3. **Annual Financial Status Report:** The Department has not filed their annual financial status report with the United States Environmental Protection Agency (EPA) for the federal fiscal year ending September 30, 2002. The report was due December 31, 2002.
4. **Annual Federal Report:** The Department did not file their annual report with the EPA for the State fiscal year ending June 30, 2002 in a timely manner. The report was due September 30, 2002, but was not filed until January 2003.
5. **Federal Cash Transaction Report:** The Department has not filed their quarterly federal cash report since January 2002. The reports were due within 15 days following the end of each quarter.
6. **Advance to the Nebraska Health and Human Services System:** The Department advanced \$183,036 to the Nebraska Health and Human Services System for payroll costs. This advance did not comply with federal cash management procedures.

More detailed information on the above items is provided hereafter. It should be noted this report is critical in nature since it contains only our comments and recommendations on the areas noted for improvement.

Draft copies of this letter were furnished to the Nebraska Department of Environmental Quality to provide them an opportunity to review and to respond to the comments and recommendations. All formal responses received have been incorporated into this letter. Responses have been objectively evaluated and recognized.

We appreciate the cooperation and courtesy extended to our auditors during the course of the audit.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

COMMENTS AND RECOMMENDATIONS

1. Cash Reconciliation

The Nebraska Accounting System (NAS) was established by the Nebraska Legislature to be the official accounting system of the State of Nebraska. Currently, the State of Nebraska is in the process of installing a new accounting system to replace NAS. Sound accounting practices and good internal controls require the assets of the Program to be separately documented in the entity's accounting records.

During our audit of the Program, we noted the Cash and Cash Equivalents as recorded on NAS were \$26,169 more than were reported on the Program's balance sheet at June 30, 2002. The Department explained this variance as posting errors made to NAS cash accounts.

While the variance is small in relation to the entire Program balance, it is important to reconcile Program activity as recorded on NAS in order to ensure all of the Program's activity was properly recorded and accounted for. If NAS is not corrected for the posting errors made during the fiscal year ended June 30, 2002, the Department will continue to have problems in future years reconciling Program cash to NAS cash. The Department did not correct the variance of \$13,757 noted in the audit for the fiscal year ended June 30, 2001. The variance continues to increase and reconciliation will become more difficult as time passes.

We recommend the Department reconcile the cash activity as recorded on NAS to actual activity of the Program every year. In addition, we recommend the Department determine errors made and make adjustments on the new accounting system.

Department's Response: The Department will continue to correct errors that are found and reconcile all activities in the SRF programs.

2. Loan Records

A significant part of accounting for the Program's activity is loan activity. Currently, the Department accounts for this activity using both internal records and NAS. The internal records include loan files for each community and ledger sheets showing loan approvals, loan payments, interest and principal payments on loans, and loan balances. This was also noted in the prior four audits for the fiscal years ending June 30, 1998, 1999, 2000, and 2001.

While the Department did reconcile their internal records to NAS, we believe it would be more efficient, and internal controls would be improved, if each loan and its activity were recorded on NAS. Efficiency would be improved because the system would record the transactions, and separate spreadsheets and reconciliations to NAS would not need to be prepared. Internal controls would be improved as there would be a reduced likelihood of posting errors, because the original transactions would be recorded based on the approved transactions, and it would not be necessary to again record the transactions on a spreadsheet.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

COMMENTS AND RECOMMENDATIONS

2. Loan Records (Concluded)

We recommend the Department work toward getting all loans and loan activities recorded on Nebraska's new accounting system.

Department's Response: All loans will be added to NIS by June 30, 2003.

3. Annual Financial Status Report

The Code of Federal Regulations (C.F.R.) establishes requirements for Federal programs. Title 40 C.F.R. Section 31.41(b)(4) (2001) states annual financial status reports for construction grants are due 90 days after the grant year. For the Program, the grant year ends each September 30.

The Department has not filed their annual financial status report with the United States Environmental Protection Agency (EPA) for the federal fiscal year ending September 30, 2002. This report was due December 31, 2002. The Department did file their annual financial status report for the federal fiscal year ending September 30, 2001 in a timely manner.

We recommend the Department implement procedures to ensure the financial status reports are filed in a timely manner and in compliance with Federal regulations.

Department's Response: The Department is in the process of filing all FSR's due. They will be filed by May 15.

4. Annual Federal Report

Title 40 C.F.R. Section 35.3570 (2001) requires the State to submit a biennial report to the EPA describing how the Program met the goals and objectives of the previous two fiscal years as stated in the Intended Use Plan and capitalization grant agreements. This report is to be filed according to the schedule established in the grant agreement. Per the grant agreement, the State must submit a biennial report to the EPA within 90 days of the end of the State fiscal year. The Department has decided to prepare an annual report, instead of the biennial report.

The Department did not file the Program's annual report for the State fiscal year ending June 30, 2002 until January 2003. This report was due September 30, 2002.

We recommend the Department implement procedures to ensure the annual reports are filed in a timely manner and in compliance with Federal regulations.

Department's Response: The Department agrees the reports were filed late.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
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COMMENTS AND RECOMMENDATIONS

5. Federal Cash Transactions Report

Title 40 C.F.R. Section 30.52(2)(iv) (2001) requires submission of the SF-272 Federal Cash Transactions Report to the EPA quarterly. This report is to be submitted within 15 days following the periods September 30, December 31, March 31, and June 30.

The Department has not yet filed the Program's Federal Cash Transactions Reports for any period since December 30, 2001.

We recommend the Department implement procedures to ensure the cash transactions reports are filed in a timely manner and in compliance with Federal regulations.

Department's Response: The Department agrees the reports have not been filed and will file them by May 15. It is our understanding that these reports are due semi-annually, not quarterly.

6. Advance to the Nebraska Health and Human Services System

Title 40 C.F.R. Section 35.3560(e) (2002) states a State may draw cash in advance to ensure funds are available to meet State payroll expenses, but cash should be drawn no sooner than necessary to meet immediate payroll disbursement needs.

In August 2001, the Department withdrew \$183,036 in funding from the Program and advanced the funding to the Nebraska Health and Human Services System (HHSS) to be used for payroll costs related to the public water supply system. As of June 30, 2002, the HHSS had not expended all of these funds and still had on hand \$61,510.

Our testing of Program withdrawals did indicate this was the only advance withdrawal made during the fiscal year tested, and a similar advance has not been made during the fiscal year ending June 30, 2003.

We recommend the Department implement procedures to ensure cash is drawn in advance only for immediate payroll disbursement needs.

Department's Response: The Department agrees that it would have been appropriate to continue the existing process of reimbursing HHSS for costs incurred, but the Department was required by statute to make this transfer. The Cash Management Improvement Act (CMIA) is not applicable to the Drinking Water State Revolving Fund and all interest earned is required to be expended in the program.

Auditors' Response: The Department should ensure all interest earned on the advanced funds by HHSS is expended by the Program.