

**AUDIT REPORT
OF THE
NEBRASKA DEPARTMENT OF
ENVIRONMENTAL QUALITY
CLEAN WATER
STATE REVOLVING FUND PROGRAM
JULY 1, 2002 THROUGH JUNE 30, 2003**

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NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND PROGRAM

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NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND PROGRAM

BACKGROUND

The Nebraska Department of Environmental Quality - Clean Water State Revolving Fund Program (Program) was established pursuant to Title VI of the Federal Clean Water Act, as amended by the Water Quality Act of 1987. Neb. Rev. Stat. Sections 81-15,147 created the Wastewater Treatment Facilities Construction Assistance Act. The Federal Water Quality Act and State statutes established the Clean Water State Revolving Fund Program to provide loans, at reduced interest rates, to finance the construction of publicly owned water pollution control facilities, non-point source pollution control projects, and estuary management plans. Instead of making grants to communities that pay for a portion of the building of wastewater treatment facilities, the Program provides for low interest loans to finance the entire cost of qualified projects. The Program provides a flexible financing source which can be used for a variety of projects. Loans made by the Program must be repaid within 20 years, and all repayments, including interest and principal, must remain in the Program.

The Program was capitalized by the United States Environmental Protection Agency (EPA) by a series of grants starting in 1989. States are required to provide an additional 20 percent of the Federal capitalization grant as matching funds in order to receive a Federal grant. As of June 30, 2003, the EPA had awarded over \$100 million in capitalization grants to the State. The award of this \$100 million required the State to contribute \$20 million in matching funds. The State provided appropriations to contribute \$.955 million of the funds to meet the State's matching requirement. Additional matching funds were obtained through the issuance of revenue bonds.

The Program is administered by the Nebraska Department of Environmental Quality (Department). The Department's primary activities with regard to the Program include the making of loans for water pollution control facilities and the management and coordination of the Program. The Nebraska Environmental Quality Council approves the rules and regulations of the Department and the Program's Intended Use Plan.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND PROGRAM

COMMENT AND RECOMMENDATION

During our audit of the Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program, we noted a certain matter relating to the financial statements which is required to be reported in accordance with Government Auditing Standards:

Nebraska Information System

Good internal control requires a plan of organization, procedures, and records, designed to safeguard assets and provide reliable financial records. Without adequate training, written procedures, and controls, there is a risk that employees may unintentionally corrupt critical data, and that errors could occur and go undetected.

During the fiscal year ended June 30, 2003, the State of Nebraska implemented significant components of a new information system called the “Nebraska Information System” (NIS). Two major components were the Payroll component, which went live on January 3, 2003, and the Financial component, which went live on March 1, 2003. All Nebraska Accounting System (NAS) financial data from July 1, 2002 through February 28, 2003 (excluding payroll from January through February as NIS payroll went live January 3, 2003) was converted to NIS as of March 1, 2003. NIS affects all Nebraska State agencies.

A consultant hired by the Auditor of Public Accounts (APA) with expertise in studying large computer systems performed a study of NIS processes and controls prior to June 30, 2003. The APA also performed a preliminary examination of internal controls as of June 30, 2003 at all State agencies in July and August of 2003. In addition, while performing examination procedures the APA has identified other concerns related to NIS.

From these studies and examinations, the APA has identified concerns and areas where improvement to NIS is needed. The following are the more significant concerns or areas where improvement is needed to ensure NIS integrity and operational efficiency:

- a. The reconciliation between the State Treasurer’s actual bank statements and records, the NAS/NIS accounting records, and the related disposition of reconciling items was not completed for November 2002 through December 2003 in a timely manner. Subsequent to December 2003, the Department of Administrative Services (DAS) Accounting Division performed some reconciliation procedures. As of April 28, 2004, the June 30, 2003 reconciliation indicates an unknown variance between the bank records and the accounting records of \$3,654,783, with the bank being short compared to the accounting records. The monthly reconciliations during the audit period and subsequent months indicate fluctuations in the variance amounts. Complete and timely reconciliation procedures between bank records and accounting records provide control over cash and accurate financial information. The reconciliation procedures should be done timely and on a monthly basis to ensure all financial information is correct in NIS.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND PROGRAM

COMMENT AND RECOMMENDATION

(Continued)

Nebraska Information System (Continued)

- b. Two key financial reports to be prepared and presented by the DAS Accounting Division were not completed in a timely manner. The Annual Budgetary Report as of June 30, 2003 was not completed until January 2004. The Comprehensive Annual Financial Report has yet to be completed for the fiscal year ended June 30, 2003. Timely reporting of the State's financial information is key to all users of such information, especially State policy makers, when making informed policy decisions.
- c. As of June 30, 2003, a comprehensive written NIS policy and procedures manual had not been prepared. Subsequent to June 30, 2003, DAS Accounting Division has made some progress in updating the prior Nebraska Accounting System (NAS) and Nebraska Employees Information System (NEIS) policy and procedures manuals to incorporate NIS policies. However, as of the date of this report these policy updates are not complete. With hundreds of users of NIS, it becomes imperative the State has a comprehensive policy and procedure manual to help ensure consistent and accurate accounting of the State's financial transactions.
- d. Labor distribution - The NIS payroll application is not allocating salaries and benefits appropriately to salaried employees who incur hours that are distributed across multiple business units. This applies to most agencies' funds, programs, and grants.
- e. A detailed analysis has not been performed to determine whether users received adequate training to enable them to appropriately perform their job functions. Training provided for the implementation of NIS was limited to navigational training and did not include explanatory informational training.
- f. A records retention policy has not been implemented to ensure an adequate audit trail is maintained for NIS information. The records retention schedules only states, "Obsolete with implementation of NIS."
- g. The payroll component is not designed to promote an effective segregation of duties.
- h. Critical function access rights - Access to sensitive General Accounting functions has been provided to individuals who may not require such access as a part of their job responsibilities.
- i. Information security procedures - The State has not documented or formalized comprehensive information security procedures for NIS.
- j. Business continuity planning - The State has not implemented a formal, comprehensive business continuity or disaster recovery plan that comprehends both NIS and its supporting infrastructure.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND PROGRAM

COMMENT AND RECOMMENDATION

(Continued)

Nebraska Information System (Concluded)

The issues identified above are the responsibility of the Department of Administrative Services Accounting Division and NIS Functional Team as they relate directly to NIS; however, they directly affect all Nebraska State agencies' financial information and must be disclosed in this report. The results of the consultant's study of NIS were communicated in a separate report to the Department of Administrative Services, who is responsible for NIS. Letters to each State agency communicated the results of the APA's preliminary examination of internal controls at the State agency level. Additional concerns identified by the APA were communicated to the appropriate State officials.

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NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY CLEAN WATER STATE REVOLVING FUND PROGRAM

INDEPENDENT AUDITORS' REPORT

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We have audited the accompanying financial statements of the business-type activities of the Nebraska Department of Environmental Quality - Clean Water State Revolving Fund Program (Program), as of and for the year ended June 30, 2003, as listed in the Table of Contents. 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 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 significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements of the Nebraska Department of Environmental Quality - Clean Water State Revolving Fund Program, are intended to present the financial position, and the changes in financial position and cash flows, of only that portion of the business-type activities of the State that is attributable to the transactions of the Nebraska Department of Environmental Quality - Clean Water State Revolving Fund Program. They do not purport to, and do not, present fairly the financial position of the State of Nebraska as of June 30, 2003, and the changes in its financial position and its cash flows for the year then ended.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of the Nebraska Department of Environmental Quality - Clean Water State Revolving Fund Program, as of June 30, 2003, and the respective changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 26, 2004, on our consideration of the Nebraska Department of Environmental Quality - Clean Water State Revolving Fund Program's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

In accordance with the *U.S. Environmental Protection Agency Audit Guide for Clean Water and Drinking Water State Revolving Fund Programs*, we have also issued our report dated May 26, 2004, on our consideration of the Nebraska Department of Environmental Quality - Clean Water State Revolving Fund Program's compliance with certain provisions of laws, regulations, and grants.

The accompanying Management's Discussion and Analysis as listed in the table of contents is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

May 26, 2004

Pat Reding, CPA

Assistant Deputy Auditor

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND PROGRAM

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

This section of the Nebraska Department of Environmental Quality Clean Water State Revolving Fund Program's (Program) financial report presents a narrative overview and analysis of the financial activities of the Program for the fiscal year ended June 30, 2003. This analysis has been prepared by management of the Department and is intended to be read with the financial statements and related footnotes that follow this section.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the Program's basic financial statements. The Program's basic financial statements include: 1) Balance Sheet, 2) Statement of Revenues, Expenses, and Changes in Net Assets, 3) Statement of Cash Flows, and 4) Notes to Financial Statements.

The Balance Sheet presents information on all of the Program's assets and liabilities, with the difference between the two reported as net assets.

The Statement of Revenues, Expenses, and Changes in Net Assets presents information showing how the Program's net assets changed during the most recent fiscal year.

The Statement of Cash Flows presents the Program's flows of cash by defined categories. The primary purpose of the Statement of Cash Flows is to provide information about the Program's cash receipts and payments during the year.

The Notes to Financial Statements provide additional information that is essential to a full understanding of the data provided in the financial statements.

ANALYSIS OF BALANCES AND TRANSACTIONS OF INDIVIDUAL FUNDS

Changes in Net Assets

For the fiscal year ended June 30, 2003, net assets of the Program increased by 7%.

	2003	2002
Current Assets	\$ 45,808,345	\$ 40,941,957
Noncurrent Assets	83,852,708	80,126,542
Total Assets	<u>129,661,053</u>	<u>121,068,499</u>
Current Liabilities	84,308	454
Noncurrent Liabilities	-	-
Total Liabilities	<u>84,308</u>	<u>454</u>
Net Assets		
Restricted	-	-
Unrestricted	129,576,745	121,068,045
Total Net Assets	<u>\$ 129,576,745</u>	<u>\$ 121,068,045</u>

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND PROGRAM

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
(Continued)

	2003	2002
Operating Revenues	\$ 5,498,176	\$ 7,368,556
Operating Expenses	961,596	2,925,102
Operating Income	4,536,580	4,443,454
Capital Federal Grants	4,094,787	12,163,828
Cash Transfers Out	(122,667)	-
Change in Net Assets	8,508,700	16,607,282
Net Assets, Beginning of Year	121,068,045	104,460,763
Net Assets, End of Year	\$ 129,576,745	\$ 121,068,045

The most significant changes from the fiscal year ended June 30, 2002 to the fiscal year ended June 30, 2003, include increases in cash in the State Treasury and loans receivable.

One bond was issued during the fiscal year. The Department of Environmental Quality has entered into a special financing arrangement with the Nebraska Investment Finance Authority (NIFA) to provide matching funds for the Program. NIFA issues the bonds and proceeds are held by the Trustee until needed for loan purposes. The 2002C Series Bonds were issued during the fiscal year for \$1,250,000. The bonds were redeemed before the end of the fiscal year.

Loans receivable increased by approximately \$3.7 million during the fiscal year. The number of communities with an outstanding balance increased by four. The City of Gibbon entered into another loan which resulted in its outstanding balance increasing by \$4 million. One of the new loans was to the City of North Platte for over \$2 million.

See the Notes to Financial Statements for additional discussion of bond issuances and loans receivable.

ECONOMIC OUTLOOK

No conditions were noted that would be expected to have a significant effect on the financial position or results of operations of the Program.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
 CLEAN WATER STATE REVOLVING FUND PROGRAM
BALANCE SHEET
 June 30, 2003

ASSETS

CURRENT ASSETS:

Cash & Cash Equivalents:	<u>Enterprise Fund</u>
Cash in State Treasury (Note 2)	\$ 38,470,300
Deposits Held by Trustee (Note 2)	7,373
Loans Receivable - Current (Note 3)	<u>7,330,672</u>
TOTAL CURRENT ASSETS	45,808,345

NON-CURRENT ASSETS:

Loans Receivable (Note 3)	<u>83,852,708</u>
TOTAL NON-CURRENT ASSETS	83,852,708

TOTAL ASSETS	\$ 129,661,053
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LIABILITIES

CURRENT LIABILITIES

Accounts Payable	<u>\$ 84,308</u>
TOTAL CURRENT LIABILITIES	84,308

NET ASSETS

Unrestricted	<u>129,576,745</u>
TOTAL NET ASSETS (Note 5)	129,576,745

TOTAL LIABILITIES AND NET ASSETS	\$ 129,661,053
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The accompanying notes are an integral part of the financial statements.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
 CLEAN WATER STATE REVOLVING FUND PROGRAM
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
 For the Year Ended June 30, 2003

	Enterprise Fund
OPERATING REVENUES:	
Loan Fees Administration (Note 6)	\$ 933,935
Interest on Loans	3,417,967
Interest on Fund Balance -Trustee	7,373
Interest on Fund Balance (Note 7)	1,138,901
TOTAL OPERATING REVENUES	5,498,176
 OPERATING EXPENSES:	
Administrative Costs	565,622
Small Town Grants (Note 8)	361,629
Interest Expense-State Match Bonds	9,555
Cost of Bond Issuance	24,790
TOTAL OPERATING EXPENSES	961,596
 OPERATING INCOME	 4,536,580
 CAPITAL CONTRIBUTIONS-FEDERAL GRANTS	 4,094,787
 CASH TRANSFERS OUT	 (122,667)
 CHANGE IN NET ASSETS	 8,508,700
 TOTAL NET ASSETS, BEGINNING OF YEAR	 121,068,045
 TOTAL NET ASSETS, END OF YEAR	 \$ 129,576,745

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

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
 CLEAN WATER STATE REVOLVING FUND PROGRAM
STATEMENT OF CASH FLOWS
 For the Year Ended June 30, 2003

	Enterprise Fund
CASH FLOWS FROM OPERATING ACTIVITIES:	
Receipts From Customers	\$ 22,351,396
Interest on Investments	1,146,274
Payments to Borrowers	(21,623,065)
Payments to Employees and Vendors	(590,412)
Small Town Grants	(361,629)
Bond Principal Receipts	1,250,000
Bond Principal Payments	(1,250,000)
Bond Interest Payments	(9,555)
NET CASH PROVIDED BY OPERATING ACTIVITIES	913,009
 CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:	
Funds Received From the Environmental Protection Agency	4,094,787
Cash Transfers Out	(122,667)
NET CASH FROM NON-CAPITAL FINANCING ACTIVITIES	3,972,120
 NET INCREASE IN CASH AND CASH EQUIVALENTS	4,885,129
 CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	33,592,544
 CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 38,477,673
 RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:	
Operating Income	\$ 4,536,580
ADJUSTMENTS TO RECONCILE OPERATING GAIN (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES:	
Increase in Loans Receivable	(3,707,425)
Increase in Accounts Payable	83,854
 NET CASH PROVIDED BY OPERATING ACTIVITIES	\$ 913,009

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

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND PROGRAM

NOTES TO FINANCIAL STATEMENTS

For the Fiscal Year Ended June 30, 2003

1. Summary of Significant Accounting Policies

- A. Basis of Presentation.** The accompanying financial statements of the Nebraska Department of Environmental Quality (Department) - Clean Water State Revolving Fund Program (Program) have been prepared in conformance with generally accepted accounting principles (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

The financial statements have been prepared primarily from accounts maintained by the State Accounting Administrator of the Department of Administrative Services.

- B. Reporting Entity.** The Clean Water State Revolving Fund Program is a program within the Department and is established under and governed by the Clean Water Act of the Federal Government and by laws of the State of Nebraska. The Department is a State agency established under and governed by the laws of the State of Nebraska. As such, the Department is exempt from State and federal income taxes. The Program's management has also considered all potential component units of the Program for which it is financially accountable, and other organizations which are fiscally dependent on the Program's management, or the significance of their relationship with the Program's management are such that exclusion would be misleading or incomplete. GASB has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body and (1) the ability of the Department to impose its will on that organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the Department.

As required by generally accepted accounting principles, these financial statements present the Nebraska Department of Environmental Quality - Clean Water State Revolving Fund Program. No component units were identified. The Program is part of the primary government for the State of Nebraska's reporting entity.

- C. Fund Structure.** The Program's accounts are maintained in accordance with the principles of fund accounting to ensure compliance with limitations and restrictions placed on the use of resources available to it. Under fund accounting, individual funds are established for the purpose of carrying on activities or attaining objectives in accordance with specific regulations, restrictions, or

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND PROGRAM

NOTES TO FINANCIAL STATEMENTS

(Continued)

1. Summary of Significant Accounting Policies (Continued)

limitations. Each individual fund is a self-balancing set of accounts recording cash and other financial resources, together with liabilities and residual equities or balances, and changes therein. The Program is made up of four funds on the State of Nebraska Accounting System. It includes the following funds as identified in the Wastewater Treatment Facilities Construction Assistance Act:

- Clean Water Facilities Funds – General Fund 10000, Federal Funds 48412 and 48413, and Bond Funds 68470, 68471, 68472, and 68473.
- Administration Funds – Cash Funds 28460, 28461, and 28462.

These funds are used to account for revenues and expenses for loans and administrative expenses of the Program.

The activity of these ten State of Nebraska funds have been combined and reported as an enterprise fund, which under governmental GAAP is a proprietary fund type. This fund type reflects transactions used to account for those operations that are financed and operated in a manner similar to a private business. The accounting for the Program's transactions in this manner is a requirement of the Environmental Protection Agency (EPA) as they and the Department have decided that the determination of revenues earned, expenses incurred, and/or net income is necessary to demonstrate the success of the Program and to assure the EPA that the Program will be available in perpetuity as intended.

- D. Basis of Accounting.** The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. An enterprise fund is accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation of the fund are included on the balance sheet. Enterprise fund operating statements present increases (i.e., revenues) and decreases (i.e., expenses) in net total assets.

Enterprise funds utilize the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

In reporting the financial activity of its enterprise fund, the Program's management applied all applicable GASB pronouncements as well as the following pronouncements issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinion, and Accounting Research Bulletins of the Committee on Accounting Procedures.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND PROGRAM

NOTES TO FINANCIAL STATEMENTS

(Continued)

1. Summary of Significant Accounting Policies (Concluded)

E. Cash and Cash Equivalents. Cash in State Treasury is maintained in a short term investment pool and is considered cash equivalents.

F. Loans Receivables. The State operates the Program as a direct loan program, whereby loans are made to communities. The entire Clean Water Program is funded, on the average, 83.33% from federal capitalization grants and 16.67% from State matching funds. Loan funds are disbursed to the local agencies as they expend funds for the purposes of the loan. Interest is calculated from the date that funds are advanced, and after the final disbursement has been made, the payment schedule identified in the loan agreement is adjusted for the actual amounts disbursed, and accrued interest during the project period. The interest rates on loans range from 3% to 4% and the terms are between 10 to 20 years. The current loans receivable amount was determined using the amount of principal payment due to the Program at June 30, 2003, which was collectible in fiscal year 2004.

No provisions were made for uncollectible accounts as all loans were current, and management believed all loans would be repaid according to the loan terms. There was a provision for the Program to intercept State aid to a community in default of its loan.

G. Accounts Payable. A cutoff is made on July 31st of each year when determining the amount of accounts payable that exists for the current year. Any information that would change this figure will be disregarded and shown as an expense of the year the payment is made and not when the liability is incurred.

2. Cash in State Treasury

Cash in State Treasury as reported on the balance sheet is under the control of the State Treasurer or other administrative bodies as determined by law. All cash deposited with the State Treasurer is maintained in a short-term investment pool. The State Investment Officer invests the deposited cash in short-term securities and other investments. All interest revenue is allocated to the general fund except allocations required by law to be made to other funds. All funds of the Clean Water State Revolving Fund Program were designated for investment during fiscal year 2003. Amounts are allocated on a monthly basis based on average balances of all invested funds.

Deposits Held by Trustee and Investments Held by Trustee. The Nebraska Investment Finance Authority (NIFA) (the "Issuer") issues revenue bonds payable by the Department from certain portions of the fund (see Bonds Payable) to provide additional funds to meet the 20% match requirements of the Capitalization Grants. Wells Fargo Bank Iowa, National Association, (Trustee), as trustee, holds these accounts. The

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND PROGRAM

NOTES TO FINANCIAL STATEMENTS

(Continued)

2. Cash in State Treasury (Concluded)

Trustee, in accordance with the Bond Indenture, establishes the appropriate accounts and invests the monies. At June 30, 2003, the cash held by the trustee of \$7,373, stated at Fair Market Value, was invested in the following investments:

	<u>Fair Market Value</u>
Money Market Account	\$ 7,373

In accordance with the GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*, deposits and investments are to be categorized as to custodial credit risk. The Money Market Accounts with a carrying amount of \$7,373 were uninsured and uncollateralized during and at the end of fiscal year 2003.

3. Loans Receivable

As of June 30, 2003, the Program had outstanding loans with 88 communities that totaled more than \$90 million. The outstanding balances of the ten communities with the largest SRF debt, which represent approximately 53 percent of the total loans, were as follows:

City	Outstanding Balance
Omaha	\$ 8,131,655
Gibbon	7,984,967
Scottsbluff	6,005,088
Kearney	5,656,367
Lincoln	4,560,066
Wahoo	3,846,485
Sarpy County SID #1	3,507,787
Gretna	2,993,730
Fremont	2,932,515
Aurora	2,742,306
Total	\$ 48,360,966

4. Bonds Payable

All Revenue bond activity occurred during the 12 month period ending June 30, 2003. There were no revenue bonds outstanding in the Program as of June 30, 2003.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND PROGRAM

NOTES TO FINANCIAL STATEMENTS

(Continued)

4. Bonds Payable (Concluded)

The Environmental Protection Agency (EPA) requires the Program to provide matching funds. During the fiscal year, the Program issued and redeemed \$1,250,000 in short-term revenue bonds to meet this requirement. Therefore, at June 30, 2003, no revenue bonds were outstanding. Bonds payable at June 30, 2003 are as follows:

	Beginning Balance	Additions	Retirement	Ending Balance
Bonds Payable	\$ -	\$ 1,250,000	\$ 1,250,000	\$ -

5. Net Assets

Included in the Net Assets is the total amount of capitalization grants drawn from the EPA by the Department. The following summarizes the capitalization grants awarded, drawn, and the remaining balance as of June 30, 2003.

Year	Grant Amount	Amount Drawn	Balance
1989	\$ 4,773,100	\$ 4,773,100	\$ -
1990	4,964,560	4,964,560	-
1991	10,821,580	10,821,580	-
1992	9,938,500	9,938,500	-
1993	9,830,300	9,830,300	-
1994	6,061,600	6,061,600	-
1995	6,263,600	6,263,600	-
1996	10,319,661	10,319,661	-
1997	3,119,900	3,119,900	-
1998	7,019,996	7,019,996	-
1999	6,857,600	6,857,600	-
2000	6,834,000	6,834,000	-
2001	6,797,400	6,797,400	-
2002	6,855,000	6,787,700	67,300
Totals	\$ 100,456,797	\$ 100,389,497	\$ 67,300

The following is a summary of changes in the total contributed capital.

Contributed Capital July 1, 2002	\$ 97,249,650
Contributed During the Year Funds - Received From EPA	4,094,787
Contributed Capital June 30, 2003	\$ 101,344,437

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND PROGRAM

NOTES TO FINANCIAL STATEMENTS

(Continued)

5. Net Assets (Concluded)

Also included in the Contributed Capital is a total of all general funds received by the Program from the Legislature of the State of Nebraska. These assets were to be used as match for the Program for the initial capitalization grant received by the State. The State contributed \$300,000 and \$655,000 in fiscal years ended June 30, 1989 and 1990, respectively.

6. Loan Fees Administration

The reported amount comes from a fee charged to loan recipients each year based on the amount of the loan outstanding. The fee ranged from .5% to 1% per annum and was collected semi-annually. Of the total collected, \$282,796 will be used as match for the FY 03 capitalization grant.

7. Interest on Fund Balance Held by State Treasurer

The reported amount represents the earnings the Program has received from idle funds invested by the Treasurer of the State of Nebraska. Interest is credited on approximately the twenty-fifth day of each subsequent month.

8. Small Town Grants

Small Town Grants are made to communities that have a population of 800 people or less. The total maximum of Small Town Grants awarded in any one fiscal year is \$500,000. The maximum a community can receive is \$100,000 concurrent with a Program loan. The Loan Fees Administration is used to fund these grants.

9. Operating Revenues and Expenses

Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the Program's principal ongoing operations. The principal operating revenue of the Program is the Loan Fees Administration. Interest revenues are also operating revenues since making loans is the primary purpose of the Program. The principal operating expenses of the Program are administration expenses and loan forgiveness. Interest expenses are also operating expenses since making loans is the primary purpose of the Program.

10. State Employees' Retirement Plan (Plan)

The Plan is a single-employer defined contribution plan administered by the Public Employees Retirement Board in accordance with the provisions of the State Employees Retirement Act and may be amended through Legislative action. In the defined

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND PROGRAM

NOTES TO FINANCIAL STATEMENTS

(Continued)

10. State Employees' Retirement Plan (Plan) (Concluded)

contribution plan, retirement benefits depend on total contributions, investment earnings, and the investment options selected. Prior to April 18, 2002 membership in the Plan was required of all permanent full-time employees on reaching the age of thirty and completion of twenty-four months of continuous service and voluntary participation was permitted for all permanent full-time or part-time employees upon reaching age twenty and twelve months of service within a five-year period. Any individual appointed by the Governor may elect not to become a member of the Plan. Legislative Bill 687 (2002), effective April 18, 2002, stated all permanent full-time employees shall begin participation in the Plan upon completion of twelve continuous months of service.

Employees contribute 4.33% of their monthly compensation until such time as they have paid during any calendar year a total of eight hundred sixty four dollars, after which time they shall pay a sum equal to 4.8% of their monthly compensation for the remainder of such calendar year. The Department matches the employee's contribution at a rate of 156% of the employee's contribution.

The employee's account is fully vested. The employer's account is vested 100% after five years participation in the plan (prior to April 18, 2002) or at retirement. Legislative Bill 687 (2002), effective April 18, 2002, changed the vesting requirement to a total of three years of participation in the system, which includes the twelve-month eligibility period or credit for participation in another governmental plan prior to actual contribution to the Plan.

For the fiscal year ended June 30, 2003, the Clean Water State Revolving Fund Program's employees contributed \$15,047 and the Department contributed \$23,473 for these employees.

11. Contingencies and Commitments

Risk Management. The Department is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; natural disasters; and health care insurance. The Department, as part of the primary government for the State, participates in the State's risk management program. The Nebraska Department of Administrative Services (DAS) Division of Risk Management is responsible for maintaining the insurance and self-insurance programs for the State. The State has chosen not to purchase insurance except for:

1. Motor vehicle liability which is insured for the first \$5 million of exposure per accident. Insurance is also purchased for medical payments, physical damage, and uninsured and underinsured motorists with various limits and deductibles.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND PROGRAM

NOTES TO FINANCIAL STATEMENTS

(Continued)

11. Contingencies and Commitments (Concluded)

2. Health care insurance for employees selecting certain coverage options. All health care insurance was purchased.
3. Employee dishonesty which is bonded for the first \$1 million annually with a \$10,000 retention per incident.
 - a. Real and personal property on a blanket basis for net loss in excess of \$200,000 per loss occurrence, with a limit of \$250,000,000 per loss occurrence. Newly acquired properties are only covered up to \$1,000,000 for 60 days or until the value of the property is reported to the insurance company. The perils of flood and earthquake are covered up to \$10,000,000.

No settlements exceeded commercial insurance coverage in any of the past three fiscal years. Health care insurance is funded in the Risk Management Internal Service Fund through a combination of employee and State contributions. Workers compensation is also funded in the Risk Management Internal Service Fund through assessments on each agency based on total agency payroll and past experience. Tort claims, theft of, damage to, and destruction of assets; errors and omissions; and natural disasters would be funded through the State General Fund or by individual agency assessments as directed by the Legislature, unless covered by purchased insurance. No amounts for estimated claims have been reported in the Nebraska Department of Environmental Quality - Clean Water State Revolving Fund's financial statements.

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NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND PROGRAM
**REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER
FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

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We have audited the financial statements of the Nebraska Department of Environmental Quality - Clean Water State Revolving Fund Program as of and for the year ended June 30, 2003, and have issued our report thereon dated May 26, 2004. The report was modified to emphasize the financial statements present only the funds of the Nebraska Department of Environmental Quality - Clean Water State Revolving Fund Program. 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.

Compliance

As part of obtaining reasonable assurance about whether the Nebraska Department of Environmental Quality - Clean Water State Revolving Fund Program's financial statements are free of material misstatement, we performed tests of its 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. 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 no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Nebraska Department of Environmental Quality - Clean Water State Revolving Fund 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. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Nebraska Department of Environmental Quality - Clean Water State Revolving Fund Program's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. A reportable condition is described in the Comments Section of the report as Nebraska Information System.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements 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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable condition noted above, we consider Nebraska Information System to be a material weakness. We also noted other matters involving the internal control over financial reporting that we have reported to management of Nebraska Department of Environmental Quality - Clean Water State Revolving Fund Program in a separate letter dated May 26, 2004.

This report is intended solely for the information and use of the Program, 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.

Pat Reding, CPA

Assistant Deputy Auditor

May 26, 2004

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REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO THE NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY CLEAN 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

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We have audited the compliance of the Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program with the types of compliance requirements described in the *U.S. Environmental Protection Agency Audit Guide for Clean Water and Drinking Water State Revolving Fund Programs* that were applicable for the year ended June 30, 2003. We audited the Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program’s compliance with requirements governing: Allowability for Specific Activities, Allowable Costs/Costs Principles, Cash Management, State Matching, Period of Availability of Funds and Binding Commitments, Program Income, Reporting, Subrecipient Monitoring, and Special Tests and Provisions.

Compliance with these requirements is the responsibility of the Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program’s management. Our responsibility is to express an opinion on the Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program’s compliance based on our audit.

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 the *U.S. Environmental Protection Agency Audit Guide for Clean Water and Drinking Water State Revolving Fund Programs*. Those standards 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 Program occurred. An audit includes

examining, on a test basis, evidence about the Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program’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 Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program’s compliance with those requirements.

As identified below and in a separate letter to the Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program’s management dated May 26, 2004, the Department did not comply with the following requirements.

- The Department did not file their annual financial status report with the United States Environmental Protection Agency (EPA) for the federal fiscal year ending September 30, 2002 in a timely manner. This report was due December 31, 2002, but was not filed until March 28, 2003. In addition, the Department did not maintain documentation to support the amounts reported on the report.
- The Department did not file their annual report with the EPA for the State fiscal year ending June 30, 2003, until April 2004. The report was due September 30, 2003.
- The Department filed their federal cash reports late. The reports were due within 15 days following the end of December 31 and June 30.

In our opinion, except for the reporting noncompliance issues described in the preceding paragraph, the Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program complied, in all material respects, with the requirements referred to above that are applicable to the Program for the fiscal year ended June 30, 2003.

This report is intended solely for the information and use of the Program, the federal awarding 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.

Pat Reding, CPA

Assistant Deputy Auditor

May 26, 2004