INDIVIDUAL ENTITY AUDIT REPORT

IDAHO DEPARTMENT OF ENVIRONMENTAL QUALITY CLEAN WATER STATE REVOLVING FUND

For the Fiscal Year Ended June 30, 2005

Report SA24705

Presentation by the

LEGISLATIVE SERVICES OFFICE

SERVING IDAHO'S

CITIZEN LEGISLATURE

LEGISLATIVE SERVICES' MISSION STATEMENT

The mission of the Legislative Services Office is to provide efficient, nonpartisan support services to Idaho's citizen legislators, to carry out legislative policies so as to strengthen the legislature's management as a separate branch of government, and to assist the legislature in carrying out its constitutional responsibilities to the highest standards of integrity and professional excellence. (Approved by the Legislative Council, January 20, 1994.)

LEGISLATIVE AUDITS' CHARGE

Legislative Audits, a division of Legislative Services, is charged by the Legislative Council to provide a financial audit of the statewide annual financial report prepared by the State Controller, as required by Idaho Code, Section 67-429. In addition to special reports and requested studies, Legislative Audits produces three types of audit reports and two types of management reports (described below) for the Joint Finance-Appropriations Committee and other interested parties. These audits, reports, and studies, which vary in scope, provide information for oversight of State finances for the legislature, government entities, and the public, as well as satisfying federal audit requirements.

DESCRIPTION	LEVEL OF SCRUTINY
COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR)	Our opinion as to the fairness of presentation of the annual statewide financial statements; a reference to our report on our consideration of the State's internal control over financial reporting and our tests of its compliance with certain laws, regulations, contracts, and grants issued under separate cover in the State's *Single Audit.*
STATEWIDE SINGLE AUDIT REPORT	Our opinion on the schedule of expenditures of federal awards in relation to the State's basic financial statements taken as a whole; a report on compliance and internal control over financial reporting based on an audit of financial statements performed in accordance with Government Auditing Standards; a report on compliance with requirements applicable to each major program, and on internal control over compliance in accordance with *OMB Circular A-133 (Audits of States, Local Governments, and Non-Profit Organizations)*; recommendations to improve the State's financial/accounting system; and recommendations and questioned costs related to federal awards. In addition, the report includes the State's basic financial statements and the related opinion thereon.
INDIVIDUAL ENTITY AUDIT REPORT	Our opinion on the fairness of presentation of the entity's financial statements; 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; if applicable, a report on compliance with requirements of each major program, and on internal control over compliance in accordance with *OMB Circular A-133.*
MANAGEMENT REPORT ON FINANCIAL PROCEDURES	A report based on specific procedures applied to the financial segments material to the statewide financial statement and an internal control review of those financial segments not deemed material to the statewide financial statements, or an audit of a major federal grant. Findings and recommendations are included, if applicable, to improve policies, procedures, compliance, controls, and the entity's overall efficiency.
MANAGEMENT REPORT ON INTERNAL CONTROL	A cyclical report highlighting the entity's internal control with findings and recommendations, if applicable, to improve the system to prevent errors, omissions, misrepresentations, oversights, and fraud, thus protecting State resources.

FOREWORD

PURPOSE OF AUDIT REPORT

Our fiscal/compliance audit of the Idaho Department of Environmental Quality, Clean Water State Revolving Fund was made to determine:

1. The adequacy and accuracy of the fiscal records and the reliability of the internal control system in order to issue an opinion on the fairness of the financial statements.

2. The degree of compliance with various State and federal requirements affecting the fiscal operations of the Fund.

3. The areas in the financial operations that could be improved.

SCOPE OF AUDIT

We examined the financial operations of the Fund for the fiscal year ended June 30, 2005.

The audit was performed in accordance with auditing standards generally accepted in the United States of America and the fiscal/compliance section of the *Government Auditing Standards* published by the U.S. General Accounting Office (GAO).

Information contained in this report was gathered from accounting and administrative records. We also interviewed Department personnel.

AUDIT AUTHORIZATION

Reported to the Joint Finance-Appropriations Committee as directed by the Legislative Council of the Idaho Legislature, authorized by Idaho Code, Section 67-429.

ASSIGNED STAFF

J.E. Bowden, Staff Auditor

ADMINISTRATION AND TECHNICAL REVIEW

Ray Ineck, CGFM, Supervisor, Legislative Audits
Thomas Haddock, CPA, CGFM, Managing Auditor

GRAPHIC LOGISTICS

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EXECUTIVE SUMMARY
LEGISLATIVE AUDITS

IDAHO DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND

PURPOSE AND SCOPE. We have audited the financial statements of the Idaho Department of Environmental Quality, Clean Water State Revolving Fund (CWSRF) for the fiscal year ended June 30, 2005, in accordance with auditing standards generally accepted in the United States of America. The purpose of our audit is to determine if the CWSRF's financial statements are materially accurate and reliable, and that the it complied with laws and regulations affecting fiscal operations. The U.S. Environmental Protection Agency (EPA) requires a separate annual financial and compliance audit of the CWSRF.

CONCLUSION. We conclude that the CWSRF's financial statements are materially accurate and reliable, and fiscal operations materially comply with related laws and regulations. As a result, we issued an unqualified opinion on the CWSRF's financial statements.

FINDINGS AND RECOMMENDATIONS. There are three findings and recommendations in this report, explained below.

FINDING #1. The accounting has errors and is not completed in a timely manner. The prior audit noted several accounting errors and financial statements that were not completed in a timely manner. This was again found to be the case. For example:

1. Net assets reported on the Statement of Net Assets do not match net assets reported on the Statement of Revenues, Expenses, and Changes in Nets Assets. The difference was $12 million.
2. Loan disbursements of $900,000 were incorrectly made from another fund instead of from the CWSRF. The Department was unaware of these incorrect disbursements.
3. Interest was miscalculated and incorrect allocations of borrower repayments between principal and interest were made.

These errors can lead to over- or underpayment of loans, incorrect management decisions, non-compliance with loan agreements, and misappropriation of assets. We believe these errors occur because only one employee completes the accounting work with little oversight. Also, the lack of a fully integrated and automated accounting system may contribute to errors.

We recommend that more than one person be trained to complete the CWSRF's accounting and that management provide timely oversight and reviews. The Department should also generate accounting reports in a timely manner, complete timely reconciliations, and consider a new accounting system.

FINDING #2. The accounting structure is unnecessarily cumbersome and inefficient. The prior audit noted that the Department used three separate funds[1] to account for the CWSRF's activities when one would suffice. The Department still uses three funds. One fund records loan repayments; a second fund, which has a large negative cash balance, records disbursements; and a third fund accounts for miscellaneous transactions, such as recording interest earnings. Additionally, the Department unnecessarily uses separate program codes for different types of loan transactions, leading to multiple codes for each loan. This current process leads to less timely and efficient reconciliations, more difficult accounting, and control weaknesses.

We recommend that the Department eliminate unnecessary funds and program codes.

FINDING #3. Documentation that supports transactions is not always adequate. As in the last audit, the Department could not provide adequate documentation for some transactions. Approval from management and borrowers for loan re-amortizations was not documented, and explanations for why repayment schedules did not agree with loan closing documents were not documented. Also, there was no documentation to explain why some payments were not recorded in accordance with the loan agreements.

We recommend that the Department document all loan decisions that affect loans or transactions related to them. Documentation should include management and borrower approval for loan re-amortizations, and explanations for why amounts on the repayment schedules do not agree with loan closing documents. Also, the loan agreements should explain how non-scheduled payments are to be recorded against the loan.

PRIOR FINDINGS AND RECOMMENDATIONS. There were three findings and recommendations in the prior report. The first finding, regarding cash investment into the long-term investment pool, was closed. In accordance with our recommendation, the Department invested $40 million in the State Treasurer's long-term investments and now completes cash flow projections. The second finding, concerning the cumbersome accounting system, is closed and repeated in this report. And the final finding, regarding the lack of supporting documentation, is also closed and repeated in this report.

AGENCY RESPONSE. The Department has reviewed the report and is in general agreement with its contents.

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[1] The State accounting system separates some funds into fund details. A fund detail, like a fund, is a separate set of self-balancing accounts, requires the same accounting effort as a fund, and, in essence, is the same as a fund. For the purpose of simplification, "funds," as used in this report, means both funds and fund details.

FINANCIAL SUMMARY. The CWSRF is financed by grants from the U.S. Environmental Protection Agency (EPA) and State matching funds. The CWSRF is used to provide loans to municipalities at reduced rates to finance construction of publicly owned wastewater pollution control facilities. The financial activity of the CWSRF for the fiscal year ended June 30, 2005 is summarized as follows:

Clean Water State Revolving Fund
Statement of Net Assets at June 30, 2005

ASSETS:	
Current Assets	
Cash	$79,367,031
Loans Receivable	2,523,918
Interest Receivable – Loans	2,051,897
Interest Receivable – Fund Balance	141,919
Total Current Assets	$84,084,765
Non-Current Assets	
Loans Receivable	76,475,934
Total Non-Current Assets	$76,475,934
TOTAL ASSETS	$160,560,699
LIABILITIES:	
Current Liabilities	$13,425
Miscellaneous Payables	
	$13,425
TOTAL LIABILITIES	
NET ASSETS:	$160,547,274
Unrestricted	
	$160,547,274
TOTAL NET ASSETS	

Clean Water State Revolving Fund
Statement of Revenues, Expenses, and Changes in Net Assets for the Year Ended June 30, 2005

Operating Revenues	
Interest Earned – Loans	$3,002,207
Total Operating Revenues	$3,002,207
Operating Expenses	
Personnel Costs	$252,550
Indirect Expenses	93,666
Other Expenses	33,840
Total Operating Expenses	$380,056
Operating Income	$2,622,151
Non-Operating Revenues	
Contributions from EPA	6,592,777
Contributions from State	1,294,360
Interest Earned – Fund Balance	1,835,428
Total Non-Operating Revenue	$9,722,565
Changes in Net Assets	$12,344,716
Net Assets – Beginning of Year	148,202,558
Net Assets – End of Year	$160,547,274

OTHER ISSUES. We discussed other, less important issues which, if changed, would improve internal control, ensure compliance, or improve efficiency.

This report is intended solely for the information and use of the Idaho Department of Environmental Quality, the U.S. Environmental Protection Agency, and the Idaho Legislature and is not intended to be, and should not be, used by anyone other than these specified parties.

We thank the director, Toni Hardesty, and her staff for their assistance and cooperation given to us during this audit.

QUESTIONS CONCERNING THIS AUDIT SHOULD BE DIRECTED TO:
Ray Ineck, CGFM, Supervisor, Legislative Audits
Thomas Haddock, CPA, CGFM, Managing Auditor

Report SA24705

AGENCY RESPONSE

STATE OF IDAHO
DEPARTMENT OF
ENVIRONMENTAL QUALITY

1410 North Hilton • Boise, Idaho 83706 • (208) 373-0502

Dirk Kempthorne, Governor
Toni Hardesty, Director

February 23, 2006

Mr. Ray Ineck, CGFM, Supervisor
Legislative Audits
State Capitol Building, Room 108
Boise, Idaho 83720-0054

Re: Audit Report – 2005 Clean Water Revolving Fund

Dear Mr. Ineck:

The Department of Environmental Quality accepts the audit report. We appreciate the hard work of your audit staff.

If you or your staff have any further questions, please contact Dave Sande, CPA, Financial Officer.

Sincerely,

Toni Hardesty
Director

Attachment

cc: Dave Sande, DEQ-Fiscal Office

FINDINGS AND RECOMMENDATIONS

FINDING #1

The accounting has errors and is not completed in a timely manner.

In the prior audit, we noted several accounting errors, and that the financial statements were not completed in a timely manner. Similar errors were noted during this audit, and again, the financial statements were not completed in a timely manner.

1. Net assets reported on the Statement of Net Assets (hereinafter referred to as the balance sheet) did not agree with net assets reported on the Statement of Revenues, Expenses, and Changes in Net Assets (hereinafter referred to as the income statement). These amounts should agree. However, they differed by $12 million.
2. Cash transactions reported on the Statement of Cash Flows did not agree with the underlying amounts on the balance sheet and income statement. In order to reconcile the cash, loan receivables were decreased by $102,000 and interest earned was decreased by $54,000. The Department could not explain the errors or why these adjustments were necessary.
3. Some financial statement amounts could not be reconciled with supporting documentation. For example, loan interest received in the State accounting system (STARS) did not agree with loan interest received in the loan accounting system.
4. Loan disbursements in the amount of $900,000 were incorrectly made from another fund instead of from the CWSRF. The Department was unaware of these incorrect disbursements.
5. At the request of the Department, an entity made a loan repayment that was $10,000 less than shown on the loan repayment schedule. There was no documentation to support this request.
6. Interest was miscalculated, and there were incorrect allocations of borrower repayments between principal and interest.

These errors can lead to entities overpaying or underpaying loan amounts, incorrect management decisions, noncompliance with loan agreements, and misappropriation of assets.

We believe these errors are caused by one employee completing the CWSRF's accounting transactions with little oversight or review. Also, the lack of a fully integrated and automated accounting system may contribute to some of these errors.

RECOMMENDATION #1

We recommend that the Department:

1. **Ensure that more than one person is trained to complete accounting transactions.**
2. **Consider purchasing a new integrated accounting system.**
3. **Generate accounting reports in a timely manner.**
4. **Enhance internal controls by completing timely reconciliations and management reviews.**

CORRECTIVE ACTION PLAN

The Department will:

1. Purchase a new loan processing program.
2. Ensure that additional staff is trained to do the Fund's accounting.
3. Generate accounting reports in a timely manner.
4. Complete timely reconciliation's of transactions and use one fund detail for accounting.

FINDING #2

<u>The accounting structure is unnecessarily cumbersome and inefficient</u>.

The prior audit report noted that the Department used three separate funds[1] to account for the CWSRF's activities when one would have sufficed. The Department still uses three funds: one to record loan repayments; a second to record loan disbursements (this fund has a large negative cash balance); and a third to account for miscellaneous transactions, such as recording interest earnings. Accounting for all CWSRF activities in one fund will allow for more timely and efficient reconciliations, and help ensure that all transactions are properly reported in accordance with governmental accounting standards.

Additionally, the Department unnecessarily uses separate program codes for different types of loan transactions. This causes more difficult accounting and reconciliations, and weakens internal controls.

We were told the use of multiple funds and program codes was a carryover from when the DEQ was part of the State Department of Health and Welfare. Staff members agree that one fund will

[1] The State accounting system separates some funds into fund details. A fund detail, like a fund, is a separate set of self-balancing accounts, requires the same accounting effort as a fund, and, in essence, is the same as a fund. For the purpose of simplification, "funds," as used in this report, means both funds and fund details.

suffice, and that the Department may have program codes that are not necessary for accurate and efficient accounting.

RECOMMENDATION #2

We recommend that the Department eliminate unnecessary funds and program codes.

CORRECTIVE ACTION PLAN

The Department will consider eliminating certain funds and program codes.

FINDING #3

Documentation supporting transactions is not always adequate.

The Department could not provide adequate documentation to support some transactions, which was also an issue in the prior audit. This lack of documentation places the Department at risk of a local entity contending that it did not agree to the transactions. Also, good documentation will protect employees from potential allegations of wrongdoing, and improve internal controls. We found that documentation could be improved in the following areas:

1. The Department re-amortized loans after some entities made prepayments. However, there were no addendums to the loan agreements or correspondence in the loan files to indicate that all parties agreed to the re-amortizations or that they were approved by management.
2. Loan repayment schedules are maintained separately from the loan agreements, and are not readily available to staff members. This may be a contributing factor to the Department having requested an entity pay an incorrect amount.
3. Unscheduled or early payments have been posted inconsistently, which may result in some entities paying more or less than others, and could also lead to misunderstandings and disagreements. Furthermore, the recording of payments is not always in accordance with the loan agreements.
4. In some instances, amounts recorded on loan receivable accounts did not agree with amounts reported on repayment schedules or loan closing documents. There was no documentation in the files to explain these differences.

RECOMMENDATION #3

We recommend that the Department maintain adequate documentation for all decisions that affect loans or transactions related to loans. The loan files should include:

1. **Documentation supporting loan re-amortizations. This documentation should include management's approval; the local entity's concurrence; and other documentation that the Department may consider**

necessary, such as correspondence memorandums or addendums to loan agreements.

2. **Documentation showing current loan repayment schedules, thus allowing all parties to understand what is due to the CWSRF for each outstanding loan.**
3. **Documentation showing compliance with the loan agreement or Department policy for recording early or non-scheduled repayments, to help ensure consistent application of loan payments.**
4. **Documentation explaining why the loan amount reported on the loan detail report does not agree with the loan amortization schedule.**

CORRECTIVE ACTION PLAN

The Department will document all loan decisions that affect the loans or transactions related to them. The files will include:

1. Justification and approvals for not accruing interest on loans.
2. Documentation that supports re-amortization of loans.
3. Documentation of loan analyses and decision making processes when considering refinancing of loans by local entities.
4. Explanations if there are variances in loan amounts reported.

CONTACT PERSON

Toni Hardesty, Director
Department of Environmental Quality
208-373-0502

PRIOR FINDINGS AND RECOMMENDATIONS

The prior report covered the fiscal year ended June 30, 2004, and included three findings and recommendations. The following explains the status of those findings and recommendations.

PRIOR FINDING #1

Investment earnings could be realized by investing in longer-term investments.

Closer monitoring of cash needs and investing in long-term investments would improve investment earnings. As of January 31, 2005, the CWSRF had more than $69 million in cash, much of which was not needed immediately and could have been invested in longer-term investments to earn higher yields. An interest rate increase of just 1% would yield about $600,000 a year.

We recommended that the Department complete a cash flow analysis and, based on the results, consider making long-term investments.

STATUS: CLOSED

The CWSRF has invested $40 million in long-term investments and completes cash flow projections in accordance with our prior audit finding.

PRIOR FINDING #2

The accounting system was cumbersome and contributed to errors. The CWSRF's accounting system is more than 15 years old and requires multiple transactions and data entries. Also, only one fiscal employee operates the system with little oversight. Furthermore, there were three funds being used to complete the accounting when one would suffice, and many unnecessary program codes were being used. This structure increases the risk of errors and makes reconciliations more difficult to complete.

We recommended that the Department use one fund to account for the CWSRF's activities, and eliminate program codes it believes is not necessary. We also recommended that the Department consider purchasing a new, integrated accounting system, ensure that more than one employee is trained to complete the CWSRF's accounting, and generate reconciliations and financial statements in a timely manner.

STATUS: CLOSED

The Department has not purchased a new accounting system, nor eliminated funds and program codes. Furthermore, one employee is still completing the accounting with little oversight, and errors are still occurring. We have closed this finding and repeated the issues in Findings #1 and #2 of the current report.

PRIOR FINDING #3

Documentation in the loan files was not always adequate to support loan transactions or other loan decisions.

Loans to local municipalities can extend several years, involve complex accounting transactions, and impact many people. Good documentation is necessary to support loan transactions and decisions, and to minimize confusion and protect all parties involved. The Department did not have documentation explaining why it did not accrue interest for certain periods on several loans, showing that management and borrowers approved loan re-amortizations, or explaining why loan repayment schedules did not agree with loan closing documents.

STATUS: CLOSED

Documentation needs to be improved. In some instances, there were no addendums to the loan agreements or correspondence in the loan files to indicate that all parties agreed to the re-amortizations, or that they were approved by management. Loan agreements did not explain how non-scheduled payments were to be reported, nor did the Department have a policy for recording non-scheduled payments. In some instances, there was no documentation in the loan files explaining why the initial loan amount recorded as a receivable did not agree with the amount reported on the repayment schedule or with the loan closing documents. We closed this finding and have repeated these issues in Finding #3 of the current report.

Legislative Services Office
Idaho State Legislature

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November 30, 2005

Unqualified Opinion on the
Basic Financial Statements

Independent Auditor's Report

Toni Hardesty, Director
Idaho Department of Environmental Quality
Statehouse Mail

We have audited the accompanying basic financial statements of the Idaho Clean Water State Revolving Fund as of and for the year ended June 30, 2005, as listed in the table of contents. These financial statements are the responsibility of the Fund'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 *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 that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Idaho Clean Water State Revolving Fund, as of June 30, 2005, and the changes in its financial position and its cash flows 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 November 30, 2005, on our consideration of the Idaho Clean Water State Revolving Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial

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reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis, on pages 14 and 15, is not a required part of the basic financial statements but is supplementary information required by the Government 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.

Very truly yours,

Thomas Haddock, CPA, CGFM
Legislative Audits

MANAGEMENT DISCUSSION AND ANALYSIS FOR THE YEAR ENDED JUNE 30, 2005

This section of the Idaho Clean Water State Revolving Fund's (CWSRF) annual audit report presents the Department of Environmental Quality's (DEQ) evaluation of the financial performance of the program for the State fiscal year 2005.

OVERVIEW OF FINANCIAL STATEMENTS

The CWSRF's basic financial statements include the Enterprise Fund financial statements and accompanying notes to the financial statements. The Enterprise Fund financial statements consist of the following required elements necessary for fair presentation:

- Statement of Net Assets – This statement presents information on all assets and liabilities of the CWSRF, with the difference between assets and liabilities reported as net assets.

- Statement of Revenues, Expenses, and Changes in Net Assets – This statement presents all revenues, expenses, and changes in net assets of the CWSRF. The information in this statement is segregated into operating revenues, operating expenses, and non-operating revenues.

- Statement of Cash Flows – This statement details the categorical sources and uses of cash within the CWSRF, and provides a reconciliation of income to net cash provided by operating activities.

- Notes to the Financial Statements – This section provides details concerning the financial activities and accounting policies and practices, as well as specific account information for the CWSRF.

These financial statements provide additional information specific to the operations of the CWSRF that is not presented in the State of Idaho's 2005 *Comprehensive Annual Financial Report* (*CAFR*). The *CAFR* includes the CWSRF; the related but separate Drinking Water State Revolving Loan Fund (DWSRF), which is also operated by the Idaho DEQ; and the Idaho Department of Water Resources' loan program. Taken together, these three programs make up the Loan Fund reported in the *CAFR*.

FINANCIAL HIGHLIGHTS FOR FISCAL YEAR 2005

- The CWSRF made $13.8 million in loan disbursements to Idaho communities for waste water treatment facilities projects. The money used for these disbursements was derived from three primary sources: $6.6 million from the Environmental Protection Agency (EPA) CWSRF capitalization grant, $1.3 million from State matching funds, and $5.4 million from operating activities and interest earnings on the CWSRF's cash balance.

- Loan repayments of $15.6 million were received, with all loans being current. Historically, the CWSRF has not experienced any loan defaults.

- The Office of the Idaho State Treasurer received and credited the CWSRF $1.8 million in interest on CWSRF cash deposits.

CONDENSED FINANCIAL INFORMATION

	FY 2004	FY 2005	Change
Total Assets	$148,215,776	$160,560,699	$12,344,923
Total Liabilities	13,218	13,425	207
Total Net Assets	$148,202,558	$160,547,274	$12,344,716
Total Operating Revenue	$2,837,645	$3,002,207	164,562
Total Operating Expenses	229,664	380,056	150,392
Total Operating Income	$2,607,981	$2,622,151	$14,170
Non-Operating Revenue	9,455,939	9,722,565	266,626
Change in Net Assets	$12,063,920	$12,344,716	$280,796
Ending Net Assets	148,202,558	160,547,274	12,344,716

FINANCIAL POSITION ANALYSIS

The Idaho CWSRF continued to show growth in fiscal year 2005 as evidenced by the $12.3 million increase in total assets. This growth in assets was primarily due to the consumption of the federal fiscal year 2003 capitalization grant and State matching funds. During fiscal year 2005, EPA grants contributed $6.6 million toward loan disbursements, while State matching funds contributed an additional $1.3 million. The CWSRF earned $3.0 million in loan interest revenue, and invested cash earned another $1.8 million.

Loan receivables as of June 30, 2005, were $78.9 million, an increase of $1.7 million from the prior year. During the year, the CWSRF made loan disbursements of $13.8 million while collecting $15.6 million in loan principal repayments.

Cash increased $13.3 million, for a balance of $79.4 million. The CWSRF continues to be in position to offer viable financial resources to Idaho Communities and is a robust enterprise in its own right. At this stage in development, the CWSRF has the capacity to make more loan disbursements from its own reserves than from the combined annual federal capitalization grant and State match.

There are no known facts, decisions, or conditions expected to have a significant affect on the CWSRF.

STATE OF IDAHO - DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND
STATEMENT OF NET ASSETS
AS OF JUNE 30, 2005

ASSETS	
Current Assets	
Cash	$79,367,031
Interest Receivable - Fund Balance	141,919
Interest Receivable - Loans	2,051,897
Loans Receivable	2,523,918
Total Current Assets	$84,084,765
Non-Current Assets	
Loans Receivable	$76,475,934
Total Non-Current Assets	$76,475,934
TOTAL ASSETS	$160,560,699
LIABILITIES	
Current Liabilities	
Payroll Payable	$9,566
Indirect Payable	3,859
Total Current Liabilities	$13,425
TOTAL LIABILITIES	$13,425
NET ASSETS	
Unrestricted	$160,547,274
TOTAL NET ASSETS	$160,547,274

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

STATE OF IDAHO - DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2005

OPERATING REVENUES	
Interest Earned - Loans	$3,002,207
Total Operating Revenues	$3,002,207
OPERATING EXPENSES	
Program Administration	
Personnel	$252,550
Indirect Administrative Expense	93,666
Travel	6,083
Operating Expense	27,757
Total Operating Expenses	$380,056
Operating Income	$2,622,151
NON-OPERATING REVENUES	
Capital Contributions	
Contributions from EPA	$6,592,777
Contributions from State	1,294,360
Interest Earned - Fund Balance	1,835,428
Total Non-Operating Revenues	$9,722,565
Change in Net Assets	$12,344,716
Net Assets - Beginning of Year as Restated	148,202,558
Net Assets - End of Year	$160,547,274

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

STATE OF IDAHO - DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2005

CASH FLOWS FROM OPERATING ACTIVITIES	
Loan and Interest Cash Flows	
Cash Received - Loan Interest Payments	$2,245,350
Cash Received - Loan Principal Repayments	15,560,575
Loan Disbursements	(13,835,699)
Subtotal Loan and Interest Cash Flows	$3,970,226
Other Operating Cash Flows	
Cash Payments - Administrative Expenses	($379,849)
Subtotal Other Operating Cash Flows	($379,849)
Net Cash Provided by Operating Activities	$3,590,377
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES	
Cash Received from EPA	$6,592,777
Cash Received as State Match	1,294,360
Cash Received - Interest on Fund Balance	1,829,081
Net Cash Provided by Non-Capital Financing Activities	$9,716,218
Net Increase in Cash	$13,306,595
Cash Balance - Beginning of Year	66,060,436
Cash Balance - End of Year	$79,367,031
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES	
Operating Income	$2,622,151
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities	
Change in Interest Receivable - Loans	(756,857)
Change in Loans Receivable	1,724,876
Change in Payables	207
Total Adjustments	$968,226
Net Cash Provided by Operating Activities	$3,590,377

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

NOTES TO FINANCIAL STATEMENTS

NOTE #1

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization of the Fund

The Clean Water State Revolving Fund (CWSRF) was established pursuant to Title VI of the Federal Water Quality Act of 1987. The Act established the CWSRF to replace the construction grants program and provide loans at reduced interest rates in order to finance construction of publicly owned water pollution control facilities. Instead of making grants to communities that pay for a portion of building wastewater treatment facilities, the CWSRF provides a flexible financing source that can be used for a variety of pollution-control projects. Loans made by the CWSRF must be repaid within 20 years, and all repayments, including interest and principal, must be returned to the CWSRF. The money in the CWSRF is to be used for eligible purposes in perpetuity.

The U.S. Environmental Protection Agency (EPA) is in the process of capitalizing the CWSRF through a series of grants which began in 1989. The State is required to provide an additional 20% of the federal capitalization grant as matching funds in order to receive a grant. As of June 30, 2005, the EPA had awarded $108,998,015 in capitalization grants to Idaho. The State has provided the required $21,799,603 in matching funds.

The CWSRF is administered by the Idaho Department of Environmental Quality (DEQ). The CWSRF does not have any full-time employees. Instead, DEQ charges the CWSRF for time spent on CWSRF activities by DEQ employees. The administrative set-aside portion of the federal grant reimburses DEQ for such costs, including salaries and benefits for employees, other direct costs, and indirect costs allocated to the CWSRF based on direct salary costs.

The financial statements are intended to present the financial position and results of the operations of the CWSRF a component of the State of Idaho. These statements are not intended to present the financial position or results of operations for the Idaho DEQ, of which the CWSRF is a part.

Basis of Accounting and Measurement Focus

Enterprise funds, in accordance with the Government Audit Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting,* are required to apply applicable GASB pronouncements, as well as the following pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements: *Statements and Interpretations of Financial Accounting Standards Board* (FASB); *Accounting Principles Board Opinions*; and *Account Research Bulletins of the Committee on Accounting Procedures*. In addition, an enterprise activity may apply all FASB statements and interpretations issued after November 30, 1989, except those that conflict with or contradict GASB pronouncements. The CWSRF has elected not to follow FASB pronouncements issued after November 30, 1989.

The CWSRF presents its financial statements as an enterprise fund. Enterprise funds are reported using the economic resources measurement focus and the accrual basis of accounting. The State's central accounting system records transactions on a cash basis of accounting. The CWSRF's financial records have been converted as necessary to an accrual basis. The accrual basis of accounting requires recording revenues when earned, and expenses when incurred.

Operating and Non-Operating Revenue and Expenses

Operating and non-operating revenue and expenses are presented separately on the operating statement. Operating revenue and expenses result from transactions associated with loan payments and disbursements, and the usual activity of the CWSRF (e.g., interest earned and administrative expenses). All other transactions are reported as non-operating revenue, such as contributions from the EPA and the State.

Cash and Cash Equivalents

Pursuant to Idaho Code, all cash in the CWSRF is deposited with the State Treasurer's Office for investment by the State Treasurer. These financial statements consider all funds deposited with the Treasurer to be cash or cash equivalents, regardless of the actual maturities of the underlying investments.

Idaho Code requires that all cash in the CWSRF be perpetually appropriated for program purposes.

Capital Assets

Capital assets are generally defined as land, land improvements, buildings, fixtures, equipment, and property under construction. The CWSRF owns no land, land improvements, buildings, fixtures, or property under construction, and has no plans to acquire any.

Loans Receivable and Interest Capitalization

Loan funds are disbursed to local agencies as the agencies incur costs for the purposes of the loan and request loan disbursements from the CWSRF. Typically, interest is calculated from the date loan funds are disbursed. After final disbursement has been made, the payment schedule identified in the loan agreement is adjusted for the actual amounts disbursed and interest accrued during the project period. At the loan closing, the loan recipient is given the opportunity to pay off any accrued interest during the construction phase or to capitalize interest with loan principal, subject to the available debt capacity of the loan recipient as stated in the loan award.

Management considers all loans to be fully collectible; therefore, no allowance for uncollectible accounts is made.

Indirect Costs – Specific Fund Liabilities

Certain liabilities, such as compensated absences, pension plan obligations, and commitments under non-capitalized (operating) leases, are obligations of DEQ, and the CWSRF receives an allocation of these costs, either through direct expenses incurred or through the application of a negotiated indirect rate.

Therefore, for the year ended June 30, 2005, the CWSRF does not have separate specific liabilities for compensated absences, pension plan obligations, or commitments under non-capitalized (operating) leases.

State Match

Under Idaho Code, the State match is perpetually appropriated from the Water Pollution Control Fund. The State is only required to deposit a cash match into the CWSRF when an actual cash draw from the EPA is made.

NOTE #2

CASH AND CASH EQUIVALENTS

The CWSRF participates in the State Treasurer's Idle Funds Investment Pool. The fund is an internal investment pool managed by the State Treasurer's Office on behalf of the participants. Money not needed to meet immediate operating obligations is invested in accordance with Idaho Code, Sections 67-1210 and 67-1210A. Participation in the pool is

non-voluntary. Idaho Code restricts the State Treasurer to certain types of investments.

Credit Risk

State law limits investments to those authorized in the Idaho Code sections listed previously. The State Treasurer has no investment policy that would further limit its investment choices.

The State Treasurer's Idle Funds Investment Pool is an unrated internal investment pool. The fair value of investments based on the CWSRF's participation in the pool as of June 30, 2005 is $79,367,031.

Interest Rate Risk

The State Treasurer does not have a formal investment policy limiting investment maturities as a means of managing exposure to fair value losses arising from increasing interest rates.

NOTE #3

LOANS RECEIVABLE

Extent, Nature, and Terms of Financial Instruments

The CWSRF makes loans to qualified agencies for projects that meet eligibility requirements of the Act. Loans are financed by capitalization grants, State match, and revolving funds. Stated interest rates on loans range between 2.0% and 4.5%, and are generally repaid over 20 years, starting within one year of project completion.

Loans by Category

At loan closing, following project completion, the State receives collateral (typically a sewer revenue bond, local improvement district bond, or promissory note) from the borrower. As of June 30, 2005, the Office of the State Treasurer held $35,496,034 (at original face value) in bonds, and $26,609,552 in promissory notes as collateral for the CWSRF.

Loans receivable at June 30, 2005 are:

	Loan Authorized	Principal Repayments	Remaining Commitment	Receivable Balance
Completed Projects	$124,952,806	$78,344,417	$0	$46,608,389
Projects in Progress	90,169,785	823,935	56,954,387	32,391,463
Totals	$215,122,591	$79,168,352	$56,954,387	$78,999,852
Less:				
Amount Due Within 1 Year				2,523,918
Loans Receivable Net of Current Maturities				$76,475,934

Projected principal repayments in subsequent years are:

Year Ending June 30	Amount
2006	$2,523,918
2007	3,597,399
2008	3,883,031
2009	4,036,729
2010	4,186,184
Thereafter	58,248,673
Total Loan Receivable	$76,475,934

NOTE #4

INTEREST RECEIVABLE

The interest rate on loans ranges between 2.0% and 4.5% and is generally repaid over 20 years, starting within one year of project completion. Details of loan interest receivable as of June 30, 2005 are:

Interest Receivable by Category	
Completed Projects	$655,704
Projects in Progress	1,396,193
Total Interest Receivable	$2,051,897

NOTE #5

CONTINGENCIES

The CWSRF is exposed to various risks of loss related to torts, asset thefts, errors or omissions, or injuries to State employees while performing CWSRF business. The CWSRF maintains insurance through the State Department of Administration Bureau of Risk Management for all risks of loss. The cost of insurance is included in the indirect costs charged to the CWSRF. There have not been any claims against the CWSRF since its inception in 1989.

NOTE #6

EPA AND STATE CONTRIBUTIONS

The CWSRF is capitalized by EPA grants authorized by Title VI of the Act, and by State matching funds. All funds drawn are recorded as non-operating revenue from the EPA and the State. As of June 30, 2005, the EPA has awarded loan and loan administration grants of $108,998,015 to the State, of which $108,874,309 has been drawn. The State has provided matching funds of $21,799,603. The following schedule summarizes the capitalization grants awarded by federal fiscal year, amounts drawn on each grant as of the balance sheet date, and balances available for future loan disbursements:

Year	EPA Grant Amount	Total Draws at June 30, 2004	Draws During SFY 2005	Total Draws at June 30, 2005	Balance at June 30, 2005
1989	$4,577,200	$4,577,200	$0	$4,577,200	$0
1990	4,738,000	4,738,000	0	4,738,000	0
1991	10,343,215	10,343,215	0	10,343,215	0
1992	9,534,900	9,534,900	0	9,534,900	0
1993	9,431,000	9,431,000	0	9,431,000	0
1994	5,813,800	5,813,800	0	5,813,800	0
1995	6,007,800	6,007,800	0	6,007,800	0
1996	6,318,400	6,318,400	0	6,318,400	0
1997	6,576,800	6,576,800	0	6,576,800	0
1998	6,577,300	6,577,300	0	6,577,300	0
1999	6,577,900	6,577,900	0	6,577,900	0
2000	6,555,200	6,555,200	0	6,555,200	0
2001	6,496,100	6,496,100	0	6,496,100	0
2002	6,510,800	6,510,800	0	6,510,800	0
2003	6,467,800	6,223,117	244,683	6,467,800	0
2004	6,471,800	0	6,348,094	6,348,094	123,706
Totals	$108,998,015	$102,281,532	$6,592,777	$108,874,309	$123,706

As of June 30, 2005, the State match contributions were:

Committed State Match	Total Match Provided at June 30, 2004	State Match Provided in SFY 2005	Total Match Provided at June 30, 2005	State Match to be Provided at June 30, 2005
$21,799,603	$20,505,243	$1,294,360	$21,799,603	$0

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November 30, 2005

Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

Joint Finance-Appropriations Committee
of the Idaho State Legislature
State Capitol Building
Statehouse Mail

Senators and Representatives:

We have audited the basic financial statements of Idaho Clean Water State Revolving Fund as of and for the year ended June 30, 2005, and have issued our report thereon dated November 30, 2005. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Idaho Clean Water State Revolving Fund'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 an opinion 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 to be 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 Fund's ability to initiate, record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the Finding and Recommendation section of the report.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components do not reduce, to a relatively low level, the risk that misstatements caused by error or fraud 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

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considered to be material weaknesses. However, we believe that none of the reportable conditions described in the Findings and Recommendation section of this report are a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Idaho Clean Water State Revolving Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct, 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.

We also noted certain additional matters that we reported to the Fund's management in a separate letter.

This report is intended solely for the information and use of the management of the Idaho Clean Water State Revolving Fund and the Idaho Legislature, and is not intended to be, and should not be, used by anyone other than these specified parties.

Very truly yours,

Thomas Haddock, CPA, CGFM
Legislative Audits

APPENDIX

HISTORY AND STATUTORY AUTHORITY

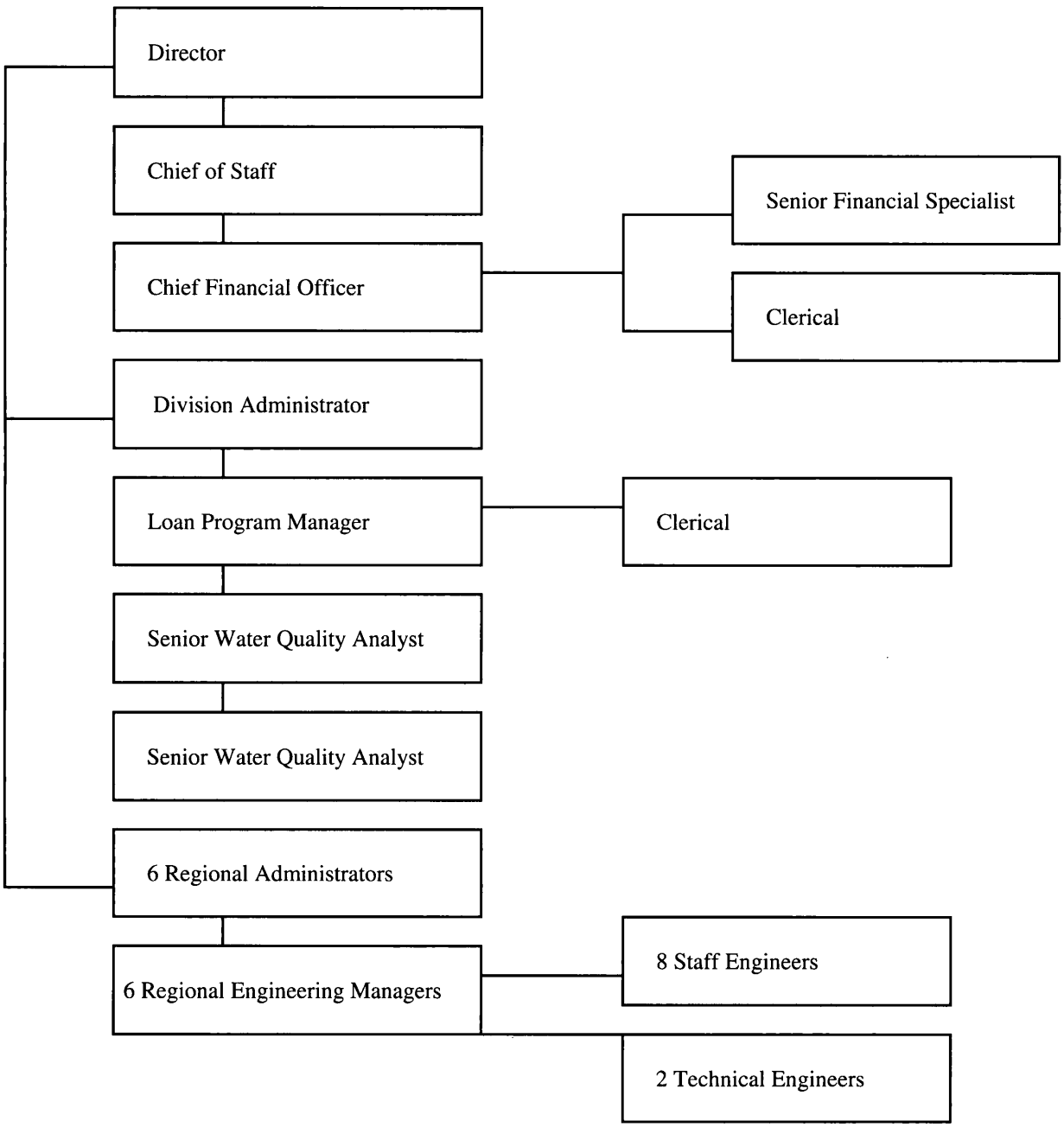
The Idaho Clean Water State Revolving Fund (CWSRF) was established pursuant to Title VI of the Federal Clean Water Act of 1987. The CWSRF has been capitalized by a series of grants from the U.S. Environmental Protection Agency beginning in 1989.

PURPOSE

The Act established the CWSRF program to provide loans at reduced rates to finance the construction of publicly owned water pollution control facilities. Instead of making grants to communities that pay for a portion of building wastewater facilities, the CWSRF provides a flexible financing source that can be used for a variety of pollution control projects. Loans made by the CWSRF must be repaid within 20 years, and all repayments, including interest and principal, must remain in the CWSRF.

ORGANIZATION AND STAFFING

The CWSRF is administered by the Idaho Department of Environmental Quality (DEQ). The CWSRF has no full-time employees, but instead uses DEQ employees on a part-time basis. The part-time positions include the CWSRF's bureau chief, senior accountant, loan program specialist, water quality analyst, four regional managers, and several staff and technical engineers.

Clean Water State Revolving Fund Organizational / Personnel Structure

June 2005