

**State of Delaware  
Delaware Water Pollution Control  
Revolving Loan Fund**

**Financial Statements**  
Years Ended June 30, 2011 and 2010

Issuance Date: April 11, 2012

**State of Delaware  
Delaware Water Pollution Control  
Revolving Loan Fund**

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**Financial Statements**  
Years Ended June 30, 2011 and 2010

**State of Delaware  
Delaware Water Pollution Control  
Revolving Loan Fund**

**Contents**

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<b>Independent Auditors' Report</b>	3-4
<b>Management's Discussion and Analysis</b>	5-10
<b>Financial Statements</b>	
Statements of Fund Net Assets	11
Statements of Revenues, Expenses and Changes in Fund Net Assets	12
Statements of Cash Flows	13
Notes to the Financial Statements	14-23
<b>Report Required by <i>Government Auditing Standards</i></b>	
Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements in Accordance with <i>Government Auditing Standards</i>	24-25
Schedule of Findings and Responses	26-27



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Wilmington, DE 19807

## Independent Auditors' Report

To the Management  
Delaware Water Pollution Control  
Revolving Loan Fund  
State of Delaware

We have audited the accompanying financial statements of the Delaware Water Pollution Control Revolving Loan Fund (the Fund) of the State of Delaware, as of and for the year ended June 30, 2011, 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. The financial statements of the Fund as of and for the year ended June 30, 2010 were audited by McBride Shopa & Company, PA, whose practice was combined with our firm, and whose report dated September 28, 2010 expressed an unqualified opinion.

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 of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Delaware Water Pollution Control Revolving Loan Fund, as of June 30, 2011, and the changes in financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1, the financial statements present only the Fund and are not intended to present fairly the financial position of the State of Delaware, and the results of its operations and cash flows of its proprietary fund types in conformity with accounting principles generally accepted in the United States of America.

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## Independent Auditors' Report (Cont'd.)

In accordance with *Government Auditing Standards*, we have also issued our report dated March 19, 2012 on our consideration of the 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 reporting or on compliance. That report is an integral part of the audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

Management's Discussion and Analysis on pages 5 through 10 is not a required part of the basic financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America. 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.

BDO USA, LLP

March 19, 2012

# State of Delaware Delaware Water Pollution Control Revolving Loan Fund

## Management's Discussion and Analysis

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As management of the Delaware Water Pollution Control Revolving Loan Fund ("Fund"), we offer readers of the Fund's financial statements this narrative overview and analysis of the financial activities of the Fund for the fiscal year ended June 30, 2011. All amounts unless otherwise indicated are expressed in thousands of dollars.

This section of the Fund's annual financial report presents management's discussion and analysis of the financial performance during the fiscal year. Please read it in conjunction with the Fund's financial statements, which follow this section.

### Overview of the Financial Statements

This discussion and analysis is an introduction to the Fund's basic financial statements. The Fund's basic financial statements are comprised of two components: Fund financial statements and notes to the financial statements.

### Financial Highlights

In fiscal year 2010 the Delaware Department of Natural Resources and Environmental Control ("DNREC") was awarded its fourteenth and fifteenth capitalization grant from the U.S. Environmental Protection Agency ("EPA"). As of June 30, 2011, DNREC has received capitalization grants in an aggregate amount of \$164,804,334 since the inception of the Fund. As of June 30, 2011, the State of Delaware has provided state match funds of \$29,113,047 since the inception of the Fund. The combined total capitalization amount at June 30, 2011 is \$193,917,381 since the inception of the Fund. As of June 30, 2010, DNREC has received capitalization grants in an aggregate amount of \$154,802,334 since the inception of the Fund. As of June 30, 2010, the State of Delaware has provided state match funds of \$27,117,142 since the inception of the Fund. The combined total capitalization amount at June 30, 2010 was \$181,919,476 since the inception of the Fund.

The Fund realized operating income of \$263,860 in fiscal year 2011, which represents a decrease of 40% from fiscal year 2010. Grants drawn down from Federal and State governments totaled \$26,224,638 in fiscal year 2011, a 152% increase from fiscal year 2010. The increase in grants drawn down was due to the additional Federal funds available due to an American Recovery and Reinvestment Act (ARRA) Grant in the amount of \$19,239,100 plus the Annual Grant award increased to \$10,005,909. The Fund realized operating income of \$438,642 in fiscal year 2010, which represents a decrease of 80% from fiscal year 2009. Grants drawn down from Federal and State governments totaled \$10,412,965 in fiscal year 2010, a 67% increase from fiscal year 2009. The increase in grants drawn down was due to the additional Federal funds available due to the award of the American Recovery and Reinvestment Act (ARRA) Grant in the amount of \$19,239,100 plus the Annual Grant award of \$3,274,300. The American Recovery and Reinvestment Act (ARRA) Grant was awarded in June of fiscal year 2009 and is restricted to projects starting construction in fiscal year 2011.

**State of Delaware  
Delaware Water Pollution Control  
Revolving Loan Fund**

**Management's Discussion and Analysis**

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Financial Highlights (continued)

Operating revenues for the year ended June 30, 2011 (including interest income on loans) increased \$561,067 or 19% from the previous year. Operating revenues (including interest income on loans) increased \$4,343 or 0% from the previous year.

Loans disbursements made totaled \$60,595,030 during fiscal year 2011, which represents an increase of \$50,249,604 or 486% from fiscal year 2010. The increase in loan disbursements is again due to the award of the ARRA Grant which provided additional Federal funds for loan disbursements. Loan collections (principal) totaled \$8,056,402 during fiscal year 2011. This represents a decrease of \$677,814 or 8% from the previous year. The decrease in fiscal year 2011 was due to the fiscal year 2010 prepayments by two borrowers, the return of \$480,680 of fiscal year 2007 borrowed funds by another borrower and the granting of a request by one borrower to make one interest only payment. Management expects principal loan collections will grow as the number of loans outstanding increases.

Loans disbursements made totaled \$10,345,426 during the fiscal year 2010, which represents an increase of \$2,521,347 or 32% from fiscal year 2009. The increase in loan disbursements is again due to the award of the ARRA Grant which provided additional Federal funds for loan disbursements. Loan collections (principal) totaled \$8,734,216 during fiscal 2010. This represents an increase of \$741,988 or 9% from the fiscal year 2009.

Statements of Fund Net Assets

The following schedule summarizes the statements of net assets (thousands of dollars) of the Fund as of June 30, 2011, 2010 and 2009:

**State of Delaware  
Delaware Water Pollution Control  
Revolving Loan Fund**

**Management's Discussion and Analysis**

(\$000's omitted)

<i>June 30,</i>	2011	2010	2009
<b>Assets</b>			
<b>Current Assets</b>			
Cash	\$ 41,060	\$ 65,362	\$ 55,514
Grants receivable	1,174	2,874	122
Administrative fees receivable	334	210	205
Interfund receivable	828	885	1,052
Interest receivable	337	209	188
Loans receivable, current	12,048	10,093	12,026
	55,781	79,633	69,107
<b>Noncurrent Assets</b>			
Loans receivable, less current portion	168,640	117,702	114,157
<b>Total Assets</b>	<b>\$ 224,421</b>	<b>\$ 197,335</b>	<b>\$ 183,264</b>
<b>Liabilities and Net Assets</b>			
<b>Current Liabilities</b>			
Vouchers payable	\$ 3,358	\$ 3,004	\$ 242
Deferred income	-	40	-
Interfund payable	828	885	1,052
<b>Total Liabilities</b>	<b>4,186</b>	<b>3,929</b>	<b>1,294</b>
<b>Net Assets</b>	<b>220,235</b>	<b>193,406</b>	<b>181,970</b>
<b>Total Liabilities and Net Assets</b>	<b>\$ 224,421</b>	<b>\$ 197,335</b>	<b>\$ 183,264</b>

**State of Delaware  
Delaware Water Pollution Control  
Revolving Loan Fund**

**Management's Discussion and Analysis**

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Statements of Fund Net Assets (continued)

The combined total net assets of the Fund for the year ending June 30, 2011 increased by \$26,829 or 14% from the fiscal year ending June 30, 2010, which increased by \$11,436 or 7% from the fiscal year ending June 30, 2009.

Cash decreased \$24,302,047 or 37% to \$41,059,757 during fiscal year 2011, primarily because of the increase in loan disbursements. Loan disbursements and administrative expenses that are usually paid from this source were instead paid from the funds provided by the award of the ARRA Grant. The total increase in liabilities of \$257,215 was due to the increase in vouchers payable at the end of the fiscal year. Vouchers payables represent the amount of disbursements/payments which were requested/earned in fiscal year 2011 but not paid until the following fiscal year. The increase is due to timing and does not reflect any long term trend.

Cash increased \$9,847,593 or 18% to \$65,361,804 during fiscal 2010 primarily because principal, interest and administrative fees received from the municipal loan repayments totaled in excess of \$10,000,000. Loan disbursements and administrative expenses that are usually paid from this source were instead paid from the funds provided by the award of the ARRA Grant. Total liabilities' increase of \$2,633,615 was due to the increase in vouchers payable at the end of the fiscal year. Vouchers payables represent the amount of disbursements/payments which were requested/earned in fiscal year 2010 but not paid until the following fiscal year. The decrease is due to timing and does not reflect any long term trend.

Statements of Revenues, Expenses and Changes in Fund Net Assets

The following schedule summarizes the statements of revenues, expenses and changes in Fund net assets (thousands of dollars) for the fiscal years ended June 30, 2011, 2010 and 2009:

**State of Delaware  
Delaware Water Pollution Control  
Revolving Loan Fund**

**Management's Discussion and Analysis**

(\$000's omitted)

<i>Years ended June 30,</i>	2011	2010	2009
<b>Operating Revenues</b>			
Interest income on loans	\$ 1,660	\$ 1,348	\$ 1,306
Administrative fee revenue	1,882	1,633	1,680
Application fees	1	1	1
Other income	1	1	1
	<b>3,544</b>	<b>2,983</b>	<b>2,988</b>
<b>Operating Expenses</b>			
Reimbursable expenditures under operating grants			
Personnel costs	1,220	1,103	580
Travel	16	9	4
Contractual services	571	167	193
Supplies	29	32	41
Other expenses	352	78	6
Grants made	1,092	1,155	-
Loans made	60,595	10,345	7,824
	<b>63,875</b>	<b>12,889</b>	<b>8,648</b>
<b>Adjustments to reconcile</b>			
Reimbursable expenditures to operating expenses			
Less: Loans made	(60,595)	(10,345)	(7,824)
<b>Total Operating Expenses</b>	<b>3,280</b>	<b>2,544</b>	<b>824</b>
<b>Operating Income</b>	<b>264</b>	<b>439</b>	<b>2,164</b>
<b>Non-Operating Revenues</b>			
Interest income on deposits	341	584	943
Contributions, EPA	24,240	9,325	5,184
Contributions, State	1,984	433	1,036
Contributions, Revolving Loan Fund	-	655	-
	<b>26,565</b>	<b>10,997</b>	<b>7,163</b>
<b>Change in Net Assets</b>	<b>26,829</b>	<b>11,436</b>	<b>9,327</b>
<b>Beginning Net Assets</b>	<b>193,406</b>	<b>181,970</b>	<b>172,643</b>
<b>Ending Net Assets</b>	<b>\$ 220,235</b>	<b>\$ 193,406</b>	<b>\$ 181,970</b>

**State of Delaware  
Delaware Water Pollution Control  
Revolving Loan Fund**

**Management's Discussion and Analysis**

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Statements of Revenue, Expenses and Changes in Fund Net Assets (continued)

The Fund reported operating revenues of \$3,544,477 during fiscal 2011, which represents an increase of \$561,067 or 19% from fiscal year 2010. The Fund reported operating revenues of \$2,983,410 during fiscal 2010, which represents an increase of \$4,343 or 0% from fiscal year 2009. This increase is primarily a result of increased loan interest and administrative fees, which were monies received as part of loan repayments. Borrowers are required to pay interest and administrative fees on funds disbursed during construction as well as throughout the life of the loan. Consequently, as the amount of loans outstanding increases for the Fund, income from interest and administrative fees will also increase. The Fund reported an overall increase of \$26,829,043 in total fund net assets for the fiscal year ended June 30, 2011, and an overall increase of \$11,435,913 in total net assets for the fiscal year ended June 30, 2010.

Federal grant revenue increased by \$14,873,734 or 159% during fiscal year 2011, as a result of increased loan disbursements, including the ARRA loans. The State match increased by \$1,551,364, or 358%. This is mainly due to the increase in loan disbursements plus the use of surplus State Match funds from previous excess allocations to the fund.

Federal grant revenue increased by \$4,140,938 or 80% during fiscal year 2010, as a result of both increased loan disbursements, including the ARRA loans. The State match decreased by \$603,469, or 58%. This is mainly due to the State of Delaware no longer funding the state match, instead requiring the Non-Federal Admin Fund to do so.

Total operating expenses increased \$735,850 or 29% during fiscal 2011, due to an increase in grants paid out of the Non Federal Administrative Fund and additional personnel costs and other expenses paid out of the Federal Administrative Fund. Total operating expenses increased \$1,720,674 or 209% during fiscal year 2010, due to an increase in loan disbursements. It is also due to an increase in grants, including \$500,000 made to the SEFO plan and \$654,860 made to fund the state portion of the loan disbursements.

Requests for Information

This financial report is designed to provide a general overview of the Fund's finances to the users of such data. Requests for additional copies of this report, questions concerning any of the information in this report, and requests for additional financial information should be addressed to:

Frank Paquette  
State of Delaware  
Department of Natural Resources & Environmental Control  
Division of Water Resources  
5 E. Reed Street, Suite 200  
Dover, DE 19901

## Financial Statements

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State of Delaware  
Delaware Water Pollution Control  
Revolving Loan Fund  
Statements of Fund Net Assets

June 30,	2011				2010			
	Federal Administrative Fund	Capital Reserve Loan Fund	Non Federal Administrative Fund	Total	Federal Administrative Fund	Capital Reserve Loan Fund	Non Federal Administrative Fund	Total
<b>Assets</b>								
<b>Current Assets</b>								
Cash equivalents	\$ 1,128	\$ 32,567,679	\$ 8,490,950	\$ 41,059,757	\$ 1,128	\$ 55,940,406	\$ 9,420,270	\$ 65,361,804
Grants receivable	-	1,174,691	-	1,174,691	-	2,873,567	-	2,873,567
Administrative fees receivable	-	-	333,946	333,946	-	-	209,681	209,681
Interfund receivable	-	-	827,725	827,725	-	-	885,442	885,442
Interest receivable	-	337,006	-	337,006	-	209,299	-	209,299
Loans receivable - current	-	12,047,528	-	12,047,528	-	10,093,154	-	10,093,154
	1,128	46,126,904	9,652,621	55,780,653	1,128	69,116,426	10,515,393	79,632,947
<b>Non-current Assets</b>								
Loans receivable - less current portion	-	168,585,730	54,442	168,640,172	-	117,701,620	-	117,701,620
<b>Total Assets</b>	<b>\$ 1,128</b>	<b>\$ 214,712,634</b>	<b>\$ 9,707,063</b>	<b>\$ 224,420,825</b>	<b>\$ 1,128</b>	<b>\$ 186,818,046</b>	<b>\$ 10,515,393</b>	<b>\$ 197,334,567</b>
<b>Liabilities and Net Assets</b>								
<b>Current Liabilities</b>								
Vouchers payable	\$ -	\$ 3,357,832	\$ -	\$ 3,357,832	\$ -	\$ 3,003,534	\$ -	\$ 3,003,534
Deferred income	-	-	-	-	-	39,366	-	39,366
Interfund payable	-	827,725	-	827,725	-	885,442	-	885,442
<b>Total Liabilities</b>	<b>-</b>	<b>4,185,557</b>	<b>-</b>	<b>4,185,557</b>	<b>-</b>	<b>3,928,342</b>	<b>-</b>	<b>3,928,342</b>
<b>Net Assets - unrestricted</b>	<b>1,128</b>	<b>210,527,077</b>	<b>9,707,063</b>	<b>220,235,268</b>	<b>1,128</b>	<b>182,889,704</b>	<b>10,515,393</b>	<b>193,406,225</b>
<b>Total Liabilities &amp; Net Assets</b>	<b>\$ 1,128</b>	<b>\$ 214,712,634</b>	<b>\$ 9,707,063</b>	<b>\$ 224,420,825</b>	<b>\$ 1,128</b>	<b>\$ 186,818,046</b>	<b>\$ 10,515,393</b>	<b>\$ 197,334,567</b>

The accompanying notes are an integral part of these statements.

State of Delaware  
Delaware Water Pollution Control  
Revolving Loan Fund  
Statements of Revenues, Expenses, and Changes in Fund Net Assets

Years ended June 30,	2011				2010			
	Federal Administrative Fund	Capital Reserve Loan Fund	Non Federal Administrative Fund	Total	Federal Administrative Fund	Capital Reserve Loan Fund	Non Federal Administrative Fund	Total
<b>Operating Revenues</b>								
Interest Income on loans	\$ -	\$ 1,660,407	\$ -	\$ 1,660,407	\$ -	\$ 1,347,828	\$ -	\$ 1,347,828
Administrative fee revenue	-	-	1,881,890	1,881,890	-	-	1,633,306	1,633,306
Application Fees	-	-	681	681	-	-	1,265	1,265
Other Income	-	1,499	-	1,499	-	1,011	-	1,011
	-	1,661,906	1,882,571	3,544,477	-	1,348,839	1,634,571	2,983,410
<b>Operating Expenses</b>								
<b>Reimbursable Expenditures Under Operating Grants</b>								
Personnel costs	470,574	-	749,510	1,220,084	644,063	-	459,753	1,103,816
Travel	-	-	15,784	15,784	6,343	-	2,443	8,786
Contractual Services	3,982	46	566,541	570,569	87,810	-	79,325	167,135
Supplies and Office Expenses	-	-	29,373	29,373	319	-	31,847	32,166
Other Expenses	59,764	(585)	293,252	352,431	63,789	378	13,838	78,005
Grants made	-	-	1,092,376	1,092,376	-	-	1,154,860	1,154,860
Loans made	-	60,595,030	-	60,595,030	-	10,345,426	-	10,345,426
	534,320	60,594,491	2,746,836	63,875,647	802,324	10,345,804	1,742,066	12,890,194
<b>Adjustments to Reconcile Reimbursable Expenditures to Operating Expenses</b>								
Less: Loans made	-	(60,595,030)	-	(60,595,030)	-	(10,345,426)	-	(10,345,426)
	-	(60,595,030)	-	(60,595,030)	-	(10,345,426)	-	(10,345,426)
<b>Total Operating Expenses</b>	534,320	(539)	2,746,836	3,280,617	802,324	378	1,742,066	2,544,768
<b>Operating Income (Loss)</b>	(534,320)	1,662,445	(864,265)	263,860	(802,324)	1,348,461	(107,495)	438,642
<b>Non-Operating Revenue</b>								
Interest income on deposits	-	284,610	55,935	340,545	-	491,038	93,268	584,306
Contributions - EPA	528,109	23,712,167	-	24,240,276	750,925	8,574,182	-	9,325,107
Contributions - State	6,211	1,978,151	-	1,984,362	51,399	381,599	-	432,998
Contributions - Revolving loan fund	-	-	-	-	-	654,860	-	654,860
	534,320	25,974,928	55,935	26,565,183	802,324	10,101,679	93,268	10,997,271
<b>Change in Net Assets - unrestricted</b>	-	27,637,373	(808,330)	26,829,043	-	11,450,140	(14,227)	11,435,913
<b>Beginning Net Assets</b>	1,128	182,889,704	10,515,393	193,406,225	1,128	171,439,564	10,529,620	181,970,312
<b>Ending Net Assets - unrestricted</b>	\$ 1,128	\$ 210,527,077	\$ 9,707,063	\$ 220,235,268	\$ 1,128	\$ 182,889,704	\$ 10,515,393	\$ 193,406,225

The accompanying notes are an integral part of these statements.

**State of Delaware  
Delaware Water Pollution Control  
Revolving Loan Fund**

**Statements of Cash Flows**

<i>Years ended June 30,</i>	2011	2010
<b>Cash flows from operating activities</b>		
Loan collections	\$ 8,056,402	\$ 8,734,216
Interest received from borrowers	1,532,700	1,326,536
Administrative fee revenue	1,757,626	1,628,226
Application fees and other revenue	2,180	2,276
State match funded by recipient	(1,131,743)	(615,494)
Loan disbursements	(60,595,030)	(7,584,363)
General expenses paid	(2,188,241)	(1,889,908)
<b>Net cash (used) provided by operating activities</b>	<b>(52,566,106)</b>	<b>1,601,489</b>
<b>Cash flows from noncapital financing activities</b>		
Grants received from EPA	25,623,921	7,042,047
State portion funded by recipient	2,299,593	619,751
<b>Net cash provided by non-capital financing activities</b>	<b>27,923,514</b>	<b>7,661,798</b>
<b>Cash flows from investing activities</b>		
Interest on deposits	340,545	584,306
<b>Net cash provided by investing activities</b>	<b>340,545</b>	<b>584,306</b>
<b>Net change in cash and cash equivalents</b>	<b>(24,302,047)</b>	<b>9,847,593</b>
<b>Cash and cash equivalents, beginning of year</b>	<b>65,361,804</b>	<b>55,514,211</b>
<b>Cash and cash equivalents, end of year</b>	<b>\$ 41,059,757</b>	<b>\$ 65,361,804</b>

**Reconciliation of Net Operating Income to Cash Used by Operating Activities**

<b>Cash flows from operating activities</b>		
Operating income	\$ 263,860	\$ 438,642
Adjustments to reconcile operating income to net cash used by operating activities:		
Administrative fees receivable	(124,265)	(5,080)
Interest receivable	(127,707)	(21,292)
Loans receivable	(52,892,926)	(1,611,210)
Vouchers payable	354,298	2,761,063
(Decrease) increase in deferred income	(39,366)	39,366
Accrued expenses	-	-
<b>Net cash (used) provided by operating activities</b>	<b>\$ (52,566,106)</b>	<b>\$ 1,601,489</b>

The accompanying notes are an integral part of these statements.

**State of Delaware  
Delaware Water Pollution Control  
Revolving Loan Fund**

**Notes to the Financial Statements**

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**1. Summary of Significant Accounting Policies**

This summary of significant accounting policies of the Delaware Water Pollution Control Revolving Loan Fund ("Fund" or "SRF") is presented to assist in understanding the Fund's financial statements. The financial statements and notes are representations of the Fund's management which is responsible for their integrity and objectivity. These accounting policies conform to generally accepted accounting principles and have been consistently applied in the preparation of the financial statements.

*General Background*

The Fund was created by the 1990 session of the Delaware General Assembly and received its first state appropriation on July 1, 1990. The Fund's purpose is to make below-market interest rate loans to local governments, individuals, and other qualifying applicants under the Environmental Protection Agency's ("EPA") Capitalization Grants for State Revolving Funds federal assistance program. The Fund's enabling legislation empowers the Department of Natural Resources and Environmental Control ("DNREC") to administer the Fund.

*Type of Entity and Division of Funds*

The Fund's activities are accounted for as a distinct operating unit and a Proprietary Fund within DNREC's Division of Water Resources. Accordingly, the financial statements of the Fund are intended to present the financial position, results of operations and cash flows of proprietary fund types of only that portion of the funds of the State of Delaware that are attributable to the transactions of the Fund.

*See accompanying independent auditors' report*

**State of Delaware  
Delaware Water Pollution Control  
Revolving Loan Fund**

**Notes to the Financial Statements**

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The Fund is divided into three sub-funds:

- The Federal Administrative Fund, which accounts for program-related administrative activities;
- The Capital Reserve Loan Fund, which accounts for capital lending and repayment activities; and
- The Non Federal Administrative Fund, which accounts for monies which the State of Delaware (“State”) has been authorized, by the EPA, to allocate from the SRF program for the State’s use. The use of these funds are governed by EPA Rules and Regulations 40 CRF Part 35 Guidance on Fees Charged by State to Recipients of Clean Water State Revolving Fund Program Assistance.

***Measurement Focus and Basis of Accounting***

The accompanying financial statements of the Fund have been prepared using the economic resources measurement focus and the accrual basis of accounting in conformity with U.S. generally accepted accounting principles applicable to governmental entities as prescribed by the Governmental Accounting Standards Board (GASB). The Fund’s activities are financed and operated as an enterprise fund. When an expense is incurred that can be paid using either restricted or unrestricted resources, it is the Fund’s policy to first apply the expense towards restricted resources and then toward unrestricted resources.

The Fund has elected to apply all applicable GASB pronouncements as well as any applicable pronouncements of the Financial Accounting Standards Board, the Accounting Principles Board or any Accounting Research Bulletins issued on or before November 30, 1989 unless those pronouncements conflict with or contradict GASB pronouncements. The Fund has elected not to follow subsequent private-sector (FASB) guidance.

***Recognition of Revenues***

Federal assistance provided by the Capitalization Grants for the SRF program is earned when qualified expenditures are incurred by the borrowers and the Fund. Matching funds provided by the State are considered earned by the same criteria. Amounts earned in excess of grant monies received from the EPA and the State are recorded as grants receivable, whereas a deficiency of such amounts is considered deferred grant revenue.

*See accompanying independent auditors’ report*

**State of Delaware  
Delaware Water Pollution Control  
Revolving Loan Fund**

**Notes to the Financial Statements**

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To permit comparability to grant revenues earned and fiscal budgets, expenditures reimbursable under the Fund's program guidelines are listed separately by object category and subtotaled in the statement of revenues, expenses and changes in Fund net assets.

Operating revenues include those that result from the Fund's lending activities. Non-operating revenues include those from non-capital financing and investing activities.

*Cash Equivalents*

Cash and cash equivalents consist of demand deposits, short-term money market funds and other deposits held by financial institutions, generally with a maturity of three months or less when purchased. Cash and cash equivalents are reported as deposits. See Note 2.

*Use of Estimates*

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**2. Cash**

*Cash:* "Cash" as reported on the statement of net assets represents the Fund's allocated share of cash, cash equivalents and investments under the control of the Treasurer of the State of Delaware ("Treasurer"). All cash is deposited with the Treasurer by State agencies and maintained by the Treasurer in various pooled funds. The Treasurer invests the deposited cash including cash float in short-term securities and other investments. However, the Fund may deposit or withdraw cash at any time without prior notice or penalty. Interest income is credited to the Fund based on the weighted average rate of return on the State's monies applied to the Fund's average daily cash balance. The classification of pooled cash of the Fund is not determinable at the entity level. Pooled investments represent those investments in units of a pool rather than specific securities. As a result, such investments are not categorized as to risk because they are not evidenced by securities that exist in a physical or book-entry form.

*See accompanying independent auditors' report*

**State of Delaware  
Delaware Water Pollution Control  
Revolving Loan Fund**

**Notes to the Financial Statements**

---

*The Cash Management Policy Board:* The State of Delaware's ("State") policy for the investment of State Funds is the responsibility of the Cash Management Policy Board (the "Board"). The Board, created by State law, establishes policies for and the terms, conditions, and other matters relating to the investment of all money belonging to the State except money in any State pension fund and money held under the State deferred compensation program.

*Investment Guidelines and Management:* The investment guidelines adopted by the Board provide, among other things, that no more than 10% of the portfolio may be invested in obligations of any one issuer other than the U.S. Government. Investments may be made only in fixed income instruments with maturities of up to five years in certain circumstances.

*Collateralization Requirements:* All State funds are required by law to be collateralized by direct obligations of, or obligations which are guaranteed by the United States of America, or other suitable obligations as determined by the Board, unless the Board shall find such collateralization not in the best interest of the State. The Board has determined that certificates of deposit and time deposits must be collateralized unless the bank issuing the certificate has assets of not less than \$5 billion and is rated not lower than "B" by Fitch, Inc.'s Bank Watch Service. The Board has also determined that State's demand deposits need not be collateralized provided that any bank that holds these funds has for the last two years, a return on average assets of 5% or greater and an average equity - capital ratio of at least 1:20.

If the bank does not meet the above criteria, collateral must consist of one or more of the following:

- (a) U.S. Government securities;
- (b) U.S. Government agency securities;
- (c) Federal Home Loan Board letters of credit;
- (d) State of Delaware securities; or
- (e) Securities of a political subdivision of the State with a Moody's Investors Service rating of "A" or better.

Additionally, the bank must ensure that those securities pledged as collateral have a market value equal to or greater than 102% of the ledger balance(s) in the account(s) each day and ensure that securities pledged are identified as held in the State's name and are segregated on the bank's records.

The cash account in the Federal Administrative Fund represents grant funds drawn to pay administrative expenses of the fund. The grant agreement permits an amount up to 4% of grant revenues over the life of the program for these administrative expenses.

*See accompanying independent auditors' report*

**State of Delaware  
Delaware Water Pollution Control  
Revolving Loan Fund**

**Notes to the Financial Statements**

---

The cash account in the Capital Reserve Loan Fund represents all principal and interest received from Fund loans. These dollars are earmarked for future loans in accordance with applicable federal regulations.

Cash from administrative fees on municipal loans is recorded in the Non-Federal Administrative Fund, and is then available to the State for use at its discretion.

**3. Loans Receivable**

The loans receivable account is made up of the following major categories:

<i>Years ended June 30,</i>	2011	2010
<b>Municipal</b>		
• Sussex County Council	\$56,712,680	\$60,490,452
• City of Wilmington	9,404,996	7,740,338
• City of Seaford	5,170,642	5,490,431
• Kent County	24,041,879	2,396,543
• City of Milford	1,996,221	1,475,979
• New Castle County	293,097	-
• Town of Selbyville	2,495,042	2,691,993
• Town of Laurel	3,690,013	3,822,388
• City of Dover	5,280,378	1,419,456
• Camden Wyoming Sewer & Water Authority	213,786	231,300
• Town of Millsboro	7,584,546	7,424,648
• Town of Bridgeville	2,585,382	2,413,808
• City of Lewes	11,167,326	11,798,171
• Inland Bays	1,810,669	-
• Town of Delmar	1,655,688	1,293,250
• North Millville	4,476,991	4,607,644
• Town of Georgetown	4,738,922	4,501,299
• City of Harrington	3,192,675	340,119
• Rehoboth Bay Conservancy	1,966,811	2,069,288
<b>ARRA Loans</b>		
• Sussex County Council	25,725,489	5,273,713
• New Castle Conservation District	2,559,862	(285,507)*
• Town of Millsboro	125,000	(122,138)*
• The Challenge Program	190,000	142,275
• Town of Smyrna	1,162,018	-

*See accompanying independent auditors' report*

**State of Delaware  
Delaware Water Pollution Control  
Revolving Loan Fund**

**Notes to the Financial Statements**

<i>Years ended June 30,</i>	2011	2010
Septic Rehabilitation Program	1,477,352	1,318,638
Agriculture Non-Point Source Loan Program	809,176	1,054,198
Dairy Loan Program	79,768	118,782
Underground Storage Tank Program	81,291	87,706
<b>Total</b>	<b>\$180,687,700</b>	<b>\$127,794,774</b>
Current portion	\$ 12,047,528	\$ 10,093,154
Long-term portion	168,640,172	117,701,620
<b>Total</b>	<b>\$180,687,700</b>	<b>\$127,794,774</b>

\* The terms of the New Castle Conservation District and Town of Millsboro ARRA loans state that only 50% of the loan is to be repaid and the other 50% would be forgiven. The portion of the loans due from the municipality was repaid in advance prior to all the funds being disbursed (See Note 8).

Interest charged on these loans ranges from 0% to 6.0% for both 2011 and 2010. Loan maturities vary, based on individual agreements. General Obligation and Municipal Revenue bonds are collateral for municipal loans; business assets and real estate are collateral for other loans.

There is no allowance for doubtful loans at June 30, 2011 and 2010, as all loans are secured and will eventually be collected. There were no material delinquent loan balances and no loan defaults for 2011 and 2010.

#### **4. Significant Source of Revenue - State Revolving Loan Grant**

The Fund currently derives a significant portion of its revenue from EPA State Revolving Fund Capitalization Grant awards and mandatory state matching funds. The total funds awarded through a series of agreements during the federal capitalization period (October 1, 1990 through June 30, 2011) were \$193,917,381 which includes the federal portion of \$164,804,334, or five-sixths, and the state matching portion of \$29,113,047, or one-sixth.

According to Federal program guidelines, the Fund may spend up to four percent (4%) of the federal awards on administrative expenses. As previously described in Note 1, a separate Administrative Fund is used to account for such costs and related revenues.

*See accompanying independent auditors' report*

**State of Delaware  
Delaware Water Pollution Control  
Revolving Loan Fund**

**Notes to the Financial Statements**

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The table below summarizes funding for the Fund over the capitalization period:

	<u>Federal</u>	<u>State</u>	<u>Total</u>
Awards made through June 30, 2011	\$ 164,804,334	\$ 29,113,047	\$ 193,917,381
Awards expended through June 30, 2011	\$ 163,258,734	\$ 29,083,925	\$ 192,342,659

During the year ended June 30, 2011, the State of Delaware determined they would no longer be providing the State match portion of one sixth. The matching portion is now the responsibility of the Revolving Loan Fund, specifically the Non-Federal Administrative Fund. During the year ended June 30, 2011, the Non-Federal Administrative Fund provided matching funds in the amount of \$1,092,376, all of which was disbursed as part of the loan receivables.

## 5. Pension Plan

Employees of the Fund are considered employees of the State of Delaware ("State") and are covered under The State Employees' Pension Plan. Total pension costs of \$61,466 for 2011 and \$63,694 for 2010 is included in the financial statements as personnel costs. Certain significant plan provisions follow:

Detailed information regarding this plan is available in the Delaware Code and the Rules and Regulations of the Board of Pension Trustees.

Plan Description and Eligibility: The State Employees' Pension Plan is a cost-sharing multiple employer defined benefit plan that covers virtually all full-time or regular part-time employees of the State, including employees of other affiliated entities.

Service Benefits: Final average monthly compensation multiplied by 2% and multiplied by years of credited service prior to January 1, 1997 plus final average compensation multiplied by 1.85% and multiplied by years of credited service after December 31, 1996, subject to minimum limitations. For this plan, final average monthly compensation is the monthly average of the highest three years of compensation.

*See accompanying independent auditors' report*

**State of Delaware  
Delaware Water Pollution Control  
Revolving Loan Fund**

**Notes to the Financial Statements**

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Vesting: Five (5) years of credited service.

Retirement: Age 62 with five (5) years of credited service; age 60 with 15 years of credited service; or after 30 years of credited service at any age.

Disability Benefits: Same as Service Benefits. Employee must have five (5) years of credited service. In lieu of disability pension benefits, over 90% of the members of the plan opted into a disability insurance program offered by the State, effective January 1, 2006.

Survivor Benefits: If employee is receiving a pension, the eligible survivor receives 50% of pension (or 75% with 3% reduction of benefit); if employee is active with at least 5 years of credited service, eligible survivor receives 75% of the benefit the employee would have received at age 62.

Contributions:

- Employer - Determined by Board of Pension Trustees.
- Employee - 3% of earnings in excess of \$6,000.

Death Benefit: \$7,000 per member.

The Delaware Public Employees' Retirement System issues a publicly available financial report that includes financial statements and required supplementary information of the plan. The financial report may be obtained by writing to the State Board of Pension Trustees and Office of Pensions, McArdle Building, Suite #1, 860 Silver Lake Boulevard, Dover, Delaware 19904-2402.

## **6. Commitments and Contingencies**

### *Operating Lease*

Beginning July 1, 1997, DNREC entered into a lease for office space, on behalf of the Fund, of which the Fund pays 75%. The three-year operating lease was effective from July 1, 1997 through June 30, 2000, but has been extended since then. Most recently, the lease was renewed expiring January 31, 2006, and currently continues on a month-to-month basis.

Rent expense, which is included in the financial statements as contractual services, was \$47,001 in 2011 and \$46,080 in 2010.

*See accompanying independent auditors' report*

**State of Delaware  
Delaware Water Pollution Control  
Revolving Loan Fund**

**Notes to the Financial Statements**

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*Loans*

The Fund has met its prior binding commitments (equal to at least one hundred twenty percent (120%) of each quarterly payment within one (1) year of receipt of that payment). As of June 30, 2011, there were binding commitments of \$17,323,715.

*Cost Reimbursement Contracts*

The Fund derives all of its non-operating revenue from EPA Capitalization Grants for State Revolving Fund program and mandatory state matching funds which are contracts based on the reimbursement of allowable costs related to the program. Costs are subject to review by the EPA. Any adjustments arising from disallowed costs are recorded in the Fund's financial statements.

**7. Risk Management**

The Fund is insured under the State of Delaware's insurance plans. The State is exposed to various risks of losses related to workers' compensation, employee health-care and accident, automobile accident, police professional malpractice and property and casualty claims. It is the policy of the State not to purchase commercial insurance to cover these risks. Instead, State management believes it is more economical to manage its risk internally and thus, covers all claim settlements and judgments out of its General Fund. The State continues to carry commercial insurance for all other risks of loss, including general liability and the remainder of the property and casualty liability. There have been no significant reductions in insurance coverage from prior years. In the past three years of insured coverage, settled claims have not exceeded commercial coverage.

Claim liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. Because actual claim liabilities depend on such complex factors as inflation, changes in legal doctrines and damage awards, the process does not result in an exact amount. Claim liabilities are re-evaluated annually to take into consideration recently settled claims, the frequency of claims, and other economic and social factors.

At June 30, 2011, there were no outstanding or pending claims against the Fund.

*See accompanying independent auditors' report*

**State of Delaware  
Delaware Water Pollution Control  
Revolving Loan Fund**

**Notes to the Financial Statements**

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**8. American Recovery and Reinvestment Act of 2009**

During fiscal year 2009, the Fund was awarded additional funding as a result of the American Recovery and Reinvestment Act of 2009 in the amount of \$19,239,100. The Fund began processing various loan applications and began disbursing the funds in fiscal year 2011. The loan agreements state that each loan will be granted principal forgiveness of between 25% and 100% of the loan amount upon completion of the project. Loan recipients are given the option of paying the unforgiven portion at loan closing. If they choose this option, all interest charges are waived and the loan is considered paid in full upon completion of the project.

**9. Non-Federal Administrative Fund**

During the year ended June 30, 2011, the State of Delaware determined that they would no longer be providing the State match portion for the EPA grants (see Note 4). This match would now be funded by the Non-Federal Administrative Fund. In addition, the Non-Federal Administrative Fund is expected to fund salary expenses for other DNREC sections, provided those salaries are directly related to water quality purposes. The Non-Federal Administrative Fund will also continue to fund the Septic Extended Funding Option (SEFO) Fund. The SEFO Fund provides grants to individuals or entities which do not qualify for a Revolving Loan. SEFO grants are not expected to be repaid to the Non-Federal Administrative Fund.

During the fiscal year ended June 30, 2011, the Non-Federal Administrative Fund funded the following:

Included as Grants made:	
State match to Capital Fund	\$ 1,092,376
Included as Personnel Costs	513,738
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Total	\$ 1,606,114
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*See accompanying independent auditors' report*



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## **Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements in Accordance with *Government Auditing Standards***

To the Management  
Delaware Water Pollution Control  
Revolving Loan Fund  
State of Delaware

We have audited the accompanying financial statements of the Delaware Water Pollution Control Revolving Loan Fund (the Fund) of the State of Delaware, as of and for the year ended June 30, 2011 and have issued our report thereon dated March 19, 2012. 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

Management of the Fund is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Fund's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Fund's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a misstatement of the Fund's financial statements will not be prevented or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

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**Independent Auditors' 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* (Cont'd.)**

However, we identified a deficiency in internal control over financial reporting, described in the accompanying schedule of findings and responses that we consider to be a significant deficiency in internal control over financial reporting. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the 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 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 or other matters that are required to be reported under *Government Auditing Standards*.

The Fund's response to the findings identified in our audit is described in the accompanying schedule of findings and responses. We did not audit the Fund's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Fund's management, the Governor, the Attorney General, the Controller General, the Office of Management and Budget, the Secretary of Finance, the Office of Auditor of Accounts, and the Environmental Protection Agency, and is not intended to be used and should not be used by anyone other than these specified parties. However, under 29 Del. C., Section 10002(d), this report is a public record and its distribution is not limited.

BDO USA, LLP

March 19, 2012

**State of Delaware  
Delaware Water Pollution Control  
Revolving Loan Fund**

**Schedule of Findings and Responses**

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**Current Year Findings:**

**FINDING 11-01:**

**Condition:** Significant adjustments were required to be made during the audit.

The Fund utilizes three programs to track its activity. The first is the State accounting system, First State Financials (FSF). This was implemented on July 1, 2010, and replaced the former system, Delaware Financial Management System (DFMS). The Fund uses Peachtree General Ledger as its internal accounting system and loan tracking software to specifically track loans made to 3<sup>rd</sup> parties.

The conversion from DFMS to FSF created some issues in that new accounts were created, old accounts were no longer used, and the nature of certain accounts changed. In addition, the Fund lost its accountant during the fiscal year. Although the Fund engaged outside accounting help, certain accounts were not properly reconciled at year-end. Certain cash, grant revenue, and State match accounts in the FSF system were not properly recorded in the Peachtree General Ledger. In addition, loan balances in the loan accounting subsidiary system were not properly reconciled to the loan balances in the Peachtree General Ledger.

**Criteria:** Proper internal control procedures require that the Fund's general ledger be in balance with the supporting loan detail in the loan subsidiary system and with the cash balances reported in the FSF system. These accounts should be reconciled on a periodic basis, and any differences adjusted or explained.

**Cause:** A combination of the new software implementations and the staff turnover accounted for the discrepancies.

**Effect:** A number of accounts in the Peachtree General Ledger did not agree to their subsidiary accounts in FSF and in the loan accounting software. There were 25 adjusting journal entries required to correct the balances in Peachtree. The bulk of the entries affected the loan receivable balances (\$3,245,050 in adjustments needed), grant drawdowns (\$1,001,416 in adjustments needed), and cash (\$551,796 in adjustments needed).

**State of Delaware  
Delaware Water Pollution Control  
Revolving Loan Fund**

**Schedule of Findings and Responses**

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**RECOMMENDATION:**

We recommend that:

1. Differences in account balances between FSF and Peachtree be reviewed and reconciled monthly.
2. Account balances in Peachtree should be updated for all activity in the loan accounting software and also reconciled on a monthly basis.

**AUDITEE'S PLAN FOR CORRECTIVE ACTION:**

Financial Assistance Branch is implementing steps to avoid this going forward as follows:

1. All FSF accounts will be reconciled with Peachtree on a monthly basis.
2. Account balances in Peachtree will be reviewed and reconciled to the loan accounting software on a monthly basis.

**Prior Year Findings:**

None