

State of Delaware
Department of Natural Resources and Environmental Control
Hazardous Substance Cleanup Fund

Financial Statements – Modified Cash Basis

For the Year Ended June 30, 2012

Report Issued: June 19, 2014

State of Delaware
Department of Natural Resources and Environmental Control
Hazardous Substance Cleanup Fund
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For the Year Ended June 30, 2012

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Zelenkofske Axelrod LLC

Independent Auditors' Report

To the Management of the State of Delaware Hazardous Substance Cleanup Fund
Dover, DE

We have audited the accompanying balance sheet – modified cash basis of the State of Delaware Hazardous Substance Cleanup Fund (“Fund”) as of June 30, 2012, and we were engaged to audit the accompanying statement of revenues, expenditure, and change in fund balance – modified cash basis of the Fund for the year ended June 30, 2012. These financial statements – modified cash basis are the responsibility of the Fund’s management.

We conducted our audit of the balance sheet – modified cash in accordance with auditing standards generally accepted in 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 unmodified opinion on the balance sheet – modified cash basis.

We were unable to confirm the beginning cash and investment balances because separate account balances are not maintained for each agency in the Delaware State Treasurer’s investment pool. All of the Fund’s money is held by the State Treasurer in those pooled funds. The beginning fund balance represents the beginning of year cash and investments which is stated at \$21,628,282 in the accompanying statement of revenues, expenditure, and change in fund balance – modified cash basis for the year ended June 30, 2012. The cash and investment balances directly relate to all reported amounts in the statement of revenues, expenditure, and change in fund balance – modified cash basis. We were unable to satisfy ourselves about the beginning of the year cash and investment balances and related impact on the amounts reported in the statement of revenues, expenditure, and change in fund balance – modified cash basis by means of other auditing procedures.

As discussed in Note B, the Fund prepares its financial statements on the modified cash basis, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

As discussed in Note A, the financial statements – modified cash basis present only the Fund and do not purport to, and do not, present fairly the financial position of the State of Delaware as of June 30, 2012, the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Because of the significance of the matter discussed in the third paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the statement of revenues, expenditure, and change in fund balance – modified cash basis.

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Zelenkofske Axelrod LLC

In our opinion, the balance sheet – modified cash basis referred to above present fairly, in all material respects, the respective financial position—modified cash basis of the Fund as of June 30, 2012, in conformity with the basis of accounting described in Note A.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 30, 2014, 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 internal control over financial 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.

We were engaged for the purpose of forming an opinion on the financial statements – modified cash basis that collectively comprise the Fund as a whole. The schedule of revenues, expenditure, and change in fund balance by account – modified cash basis on page 11 is presented for purposes of additional analysis and is not a required part of the financial statement – modified cash basis. Because of the significance of the matter described in the third paragraph, it is inappropriate to and we do not express an opinion on the supplemental information referred to above.

Harrisburg, PA
May 30, 2014



ZELENKOFESKE AXELROD LLC

State of Delaware
Department of Natural Resources and Environmental Control
Hazardous Substance Cleanup Fund
Balance Sheet - Modified Cash Basis
June 30, 2012

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Assets:

Cash and cash equivalents	\$ 12,607,977
Investments	<u>20,397,198</u>
Total Assets	<u><u>\$ 33,005,175</u></u>

Fund Balance:

Restricted by enabling legislation	<u><u>\$ 33,005,175</u></u>
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The accompanying notes are an integral part of the financial statements.

Department of Natural Resources and Environmental Control
Hazardous Substance Cleanup Fund
Statement of Revenues, Expenditure, and Change in Fund Balance - Modified Cash Basis
For the Year Ended June 30, 2012

Revenues:	
Tax assessments	\$ 20,079,250
Cost recovery	154,902
Voluntary cleanup	609,941
Interest	148,661
Other	<u>2,049</u>
Total Revenues	20,994,803
Expenditure:	
Cleanup program	<u>9,617,910</u>
Total Expenditure	<u>9,617,910</u>
Net Change in Fund Balance	11,376,893
Fund Balance - Beginning of Year	<u>21,628,282</u>
Fund Balance - End of Year	<u><u>\$ 33,005,175</u></u>

Note A - Summary of Operations

In July of 1990, the State of Delaware (the State) legislature passed, and the Governor signed, legislation establishing the State's "Hazardous Substance Cleanup Act" (HSCA). This Act establishes standards to be followed to protect the public health and welfare of citizens and the environment of the State from releases of hazardous substances. The Act also provides a funding mechanism for the program.

The responsibility for administering the Act was vested in the Division of Air and Waste Management (the Division) within the Department of Natural Resources and Environmental Control (DNREC). Two branches were created within the Division: the Superfund Branch and the Underground Storage Tank Branch, which together make up the Hazardous Substance Cleanup Fund (the Fund). Both branches are funded primarily by a surtax on certain petroleum products sold in the State.

The State's Superfund Branch supplements the federal government's efforts in cleaning up hazardous sites. The most serious sites in the State become the responsibility of the Federal Government while those that meet lesser criteria become the responsibility of the State.

The Fund's activities are accounted for as a distinct operating unit within the Division. Accordingly, the financial statements of the Fund are intended to present only the transactions related to cash, cash equivalents and investments, and the related revenues and expenditures of only that portion of the funds of the State that are attributable to the transactions of the Fund.

The Fund is divided into three subfunds: The "Cleanup Fund" for the remediation activities of the Fund and the collection of tax assessments and other revenues, the "Administrative Account" for the administrative activities of the Fund as well as the cost recovery program, and the "Voluntary Cleanup Program" for the oversight of voluntary cleanup efforts. Funds are collected and deposited directly into the appropriate subfund where they sit until cash disbursements are made.

These financial statements present only the revenues, expenditures, investments, and cash balance of the Fund, which includes hold appropriations 30078 and 30087, revenue appropriations 77801, 77802, 78701, and spend appropriations 67800, 67801, 67802, and 68700 and are not intended to present the financial position and results of operations of the State taken as a whole. As discussed in Note B, these financial statements were prepared on the modified cash basis of accounting. The modified cash basis of accounting differs from accounting principles generally accepted in the United States of America (GAAP). GAAP includes all relevant Government Accounting Standards Board (GASB) pronouncements.

Note B - Summary of Significant Accounting Policies

Basis of Accounting

The Fund's financial statements are prepared on the modified cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. Under that basis, the only assets recognized are cash and investments, no liabilities are recognized. Consequently, revenues from all sources are recognized when received, rather than when earned; and expenditures are recognized when cash, cash equivalents or

Department of Natural Resources and Environmental Control
Hazardous Substance Cleanup Fund
Notes to Financial Statements – Modified Cash Basis - Continued
June 30, 2012

Note B - Summary of Significant Accounting Policies –Continued

investments are disbursed, rather than when the obligation is incurred. The statement of revenues, expenditure, and change in fund balance present sources and uses of available spendable financial resources during a given period and use fund balance as the measure of available spendable financial resources at the end of the period. Investments are recorded at fair value and changes in fair value are included as interest income in the statement of revenues, expenditure, and change in fund balance.

As a result of the use of this modified cash basis of accounting, certain assets and their related revenues and certain liabilities and their related expenditures are not recorded in these financial statements.

Fund Balance

In the financial statements, fund balance is classified as follows:

- a. Nonspendable – Amounts that cannot be spent either because they are not in a spendable form or because they are legally or contractually required to be maintained intact.
- b. Restricted – Amounts that can be spent only for specific purposes because of the Delaware Code, state or federal laws, or externally imposed conditions by grantors or creditors.
- c. Committed – Amounts that can be used only for specific purposes pursuant to constraints imposed by a formal action of the Delaware Legislature, the State’s highest level of decision-making authority. Formal action is the passage of law by the legislature, or other parties named by the State’s legislature, creating, modifying, or rescinding an appropriation.
- d. Assigned – Amounts that are constrained by the Fund’s intent to be used for a specific purpose. Intent can be expressed by the Secretary of DNREC or by an official or body to which the Secretary delegates the authority.
- e. Unassigned – All amounts not included in other spendable classifications.

All fund balance is restricted per enabling legislation.

When an expenditure is incurred for which either restricted or unrestricted resources can be used, the Fund’s policy is to first apply the expenditure toward restricted fund balance and then to other, less-restrictive classifications – committed and then assigned fund balances before using unassigned fund balances.

Use of Estimates

The preparation of financial statements in conformity with the modified cash basis of accounting requires management to make estimates and assumptions that affect certain reported amounts and disclosures in the financial statements. Actual results could differ from those estimates.

Note C - Deposits and Investments

Deposits and Investments - State Treasurer’s Pool

Cash and cash equivalents and investments, as reported on the balance sheet, represent the Fund's allocated share of cash, cash equivalents, and investments under the control of the Treasurer of the State of Delaware (the Treasurer). All cash is deposited with the Treasurer by State agencies and

Note C - Deposits and Investments – Continued

maintained by the Treasurer in various pooled funds. The Treasurer invests the deposited cash, including cash float in short-term securities and other investments. 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 monthly spending authority. Pooled investments represent those investments in units of a pool rather than specific securities. Since the Fund's deposits and investments are part of the State's pooled deposits and investments maintained by the Treasurer, the required disclosures related to risks are included in the 2012 Delaware Comprehensive Annual Financial Report.

The Cash Management Policy Board

The State's 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 that 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 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:

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

Note C - Deposits and Investments - Continued

Additionally, the bank must ensure that those securities pledged as collateral have a market value equal to or greater than 102% of the legal 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 Policy is available on the Office of the State Treasurer website (<http://treasury.delaware.gov/>).

The following table illustrates the cash and cash equivalents, and investments of the fund held by the Treasurer at June 30, 2012:

	<u>June 30, 2012</u>	
Cash and cash equivalents	\$ 12,607,977	38.2%
Investments – short-term	17,921,810	54.3%
Investments – long-term	<u>2,475,388</u>	<u>7.5%</u>
Total held by Treasurer	<u>\$ 33,005,175</u>	<u>100.0%</u>

Note D - Revenues

The Fund's primary source of revenues comes from the levy of a 0.9% tax on all taxable gross receipts from the sale of petroleum and petroleum products, with the exception of crude oil.

Although funding is adequate to meet DNREC's annual expenditure plans and carryover funds exist, the cost of the future cleanup of orphaned sites exceeds the money available in the Fund.

Note E - Commitments

DNREC has identified over 755 sites in Delaware as potential hazardous substance release sites, some of which have been assigned a higher priority (identified as posing a risk to public health, welfare, and/or the environment). These sites are being addressed either under HSCA or under the Federal Superfund Program (National Priority List), with work complete at many of the sites. Additionally, since the inception of Delaware's Voluntary Cleanup Program (begun in 1993) and the Brownfields Program (begun in 1995), 354 sites have entered the program; 165 sites are currently undergoing cleanup; and 156 sites have been cleaned up for reuse. The cost of cleaning up the remaining sites exceeds the money available to the Fund.

Note F - Leases

On August 23, 2010 the Fund signed an amendment to an original lease dated January 23, 1998 for a cancelable seven-year operating lease agreement for office space located at 391 Lukens Drive, Riveredge Industrial Park, New Castle, Delaware. The amendment to the original lease commenced on November 1, 2010 and is cancelable only upon loss of funding. The total lease expense for the Fund for the year ended June 30, 2012 was \$329,830.

Future minimum lease payments under cancelable operating leases as of June 30, 2012 for the Fund are as follows for the years ending June 30:

2013	\$ 338,894
2014	349,061
2015	359,533
2016	370,319
2017	381,428
Thereafter	<u>128,389</u>
Total	<u><u>\$ 1,927,624</u></u>

Note G - Change in Legislation

House Bill 234 of the 144th General Assembly amended 7 Del. C. c. 91. to ensure that the tax surcharge imposed by HSCA is paid only once, regardless of how many times petroleum products are resold, for all petroleum gross receipts received after June 30, 2007. Previously, taxed petroleum products were reported by vendors on Form 9114W and attached to their gross receipts report.

Note H - Employee Benefits

Employees of the Fund are considered employees of the State and are covered by pension, health insurance, and other employee benefit programs administered by the State.

The Fund contributes to the State Employees' Pension Plan (the Pension Plan). Total pension payments of \$242,537 is included in the financial statement. The 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.

Certain significant Pension Plan provisions follow:

1. Retirement - Individuals hired prior to January 1, 2012, age 62 with 5 years of credited service; age 60 with 15 years of credited service; or after 30 years of credited service at any age. Individuals hired on or after January 1, 2012, age 65 with 10 years of credited service; age 60 with 20 years of credited service; or after 30 years of credited service at any age.
2. Service Benefits – Final average monthly compensation multiplied by 2.0% 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.

Note H - Employee Benefits – Continued

3. Disability Benefits – Pre-2012 date of hire: Same as Service Benefits. Employee must have five years of credited service. In lieu of disability pension benefits, over 90% of the members of this plan opted into a disability insurance program offered by the State effective January 1, 2006. Post-2011 date of hire: in the disability insurance program
4. Vested pension - Pre-2012 date of hire: Five years of credited service. Post-2011 date of hire: 10 years of credited service.
5. Survivor Benefits-If employee is receiving a pension, the eligible survivor receives 50% of the 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.
6. Contributions -
 - a. Employer - Determined by Board of Pension Trustees.
 - b. Pre-2012 date of hire Member - 3% of earnings in excess of \$6,000.
 - c. Post-2011 date of hire Member – 5% of earnings in excess of \$6,000.
7. Burial Benefit- \$7,000 per member.

Detailed information concerning the Pension Plan is presented in its publicly available annual basic financial statements, which can be obtained by writing the State Board of Pension Trustees and Office of Pensions at Suite 1, 860 Silver Lake Boulevard, Dover, Delaware 19904 or by calling 1-800-722-7300.

Information regarding the Other Post-Retirement Employee Benefit (OPEB) valuation is available in the State's comprehensive annual financial report.

Supplemental Information

Department of Natural Resources and Environmental Control
Hazardous Substance Cleanup Fund
Schedule of Revenues, Expenditure, and Change in Fund Balance by Account - Modified Cash Basis
For the Year Ended June 30, 2012

	<u>Administrative Account</u>	<u>Cleanup Account</u>	<u>Voluntary Cleanup Account</u>	<u>Total</u>
Revenues:				
Tax assessments	\$ -	\$ 20,079,250	\$ -	\$ 20,079,250
Cost recovery	154,902	-	-	154,902
Voluntary cleanup	-	-	609,941	609,941
Interest	-	147,924	737	148,661
Other	-	1,578	471	2,049
	<hr/>	<hr/>	<hr/>	<hr/>
Total Revenues	154,902	20,228,752	611,149	20,994,803
Expenditure:				
Cleanup program	1,563,856	7,878,318	175,736	9,617,910
	<hr/>	<hr/>	<hr/>	<hr/>
Net Change in Fund Balance	(1,408,954)	12,350,434	435,413	11,376,893
Fund Balance - Beginning of Year	4,406,720	17,156,696	64,866	21,628,282
	<hr/>	<hr/>	<hr/>	<hr/>
Fund Balance - End of Year	<u>\$ 2,997,766</u>	<u>\$ 29,507,130</u>	<u>\$ 500,279</u>	<u>\$ 33,005,175</u>

Zelenkofske Axelrod LLC

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*

To the Management of the State of Delaware Hazardous Substance Cleanup Fund
Dover, Delaware

We have audited the accompanying balance sheet – modified cash basis of the State of Delaware Hazardous Substance Cleanup Fund (“Fund”) as of June 30, 2012, and we were engaged to audit the accompanying statement of revenues, expenditure, and change in fund balance – modified cash basis of the Fund for the year ended June 30, 2012, and have issued our report thereon dated May 30, 2014. We did not express an opinion on the statement of revenues, expense, and changes in fund balance – modified cash basis because we were unable to confirm beginning cash and investment balances and related impact on the amounts reported in the statement of revenues, expenditure, change in fund balance – modified cash basis, as separate account balances are not maintained by the State. We were engaged to conduct 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.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings and responses, we identified a certain deficiency in internal control over financial reporting that we consider to be a material weakness.

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 a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described as finding 12-01 in the accompanying schedule of findings and responses to be a material weakness.

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Fund's financial statements – modified cash basis is 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 – modified cash basis 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 an instance of noncompliance or other matter that is required to be reported under *Government Auditing Standards* and which is described in the accompanying schedule of findings and responses as finding 12-01.

The Fund's response to the finding 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 management and others within the entity and is not intended to be and should not be used by anyone other than these specified parties.



Zelenkofske Axelrod LLC

Harrisburg, PA
May 30, 2014

State of Delaware
Department of Natural Resources and Environmental Control
Hazardous Substance Cleanup Fund
Schedule of Findings and Responses
June 30, 2012

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Finding 12-01

Cash Reconciliations

- Criteria:** Title 7, Chapter 91 of the State of Delaware Code, the enabling legislation that created and governs the Hazardous Substance Cleanup Fund, also known as the “Hazardous Substance Cleanup Act” requires that funds collected under the act be maintained in a separate account, or series of accounts, that are dedicated solely to providing for eligible costs under the act.
- Condition:** The State is not able to provide a report that distinguishes cash balances by agency or department. The fund utilizes account coding within the State accounting system (FSF) to segregate the various funding streams of the program. However, as the State is unable to provide cash balances at the agency level that supports the FSF accounts, we were unable to verify that funds were properly segregated. Procedures over ending balances of State Treasurer’s reconciliations were performed to ensure that adequate funds were available. As a result, we were unable to verify compliance with the aforementioned criteria at the beginning and during the year.
- Cause:** The State is not able to provide a report or reconciliation that distinguishes cash balances by agency or department at the beginning or during the year. Internal controls over segregation of cash at the State at the beginning and during the year are not operating effectively.
- Effect:** Compliance with requirements of the Hazardous Substance Cleanup Act was not able to be verified because cash balances at the beginning and during the year for the Fund were unable to be determined.
- Recommendation:** The Fund and State should be able to provide a reconciliation of cash balances at the agency and department level that corresponds to the FSF accounting system to ensure funds are adequately segregated.
- Management’s Response:** It is the Department’s opinion this is a State-wide system issue that we have no authority to change and/or correct.

Department of Natural Resources and Environmental Control
Hazardous Substance Cleanup Fund
Summary Schedule of Prior Audit Findings
June 30, 2012

The summary which follows indicates the current year status of findings identified in the prior year audit report.

Prior Year Findings

<u>Prior Year Finding</u>	<u>Brief Description of Finding</u>	<u>Current Year Status</u>
11-01	15% Administrative Cost Cap	Resolved
11-02	Cash Reconciliations	See Finding 12-01
11-03	Accounting Records	Resolved