



Certified Public Accountants and Consultants

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

Financial Statements

Years Ended June 30, 2012 and 2011

Report Issued: April 29, 2013

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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, 2012, 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 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, 2012, 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.

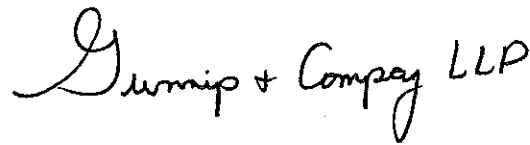
The financial statements of the Fund as of June 30, 2011, were audited by other auditors whose report dated March 19, 2012, expressed an unqualified opinion on those financial statements.

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.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 12, 2013 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 3 through 7 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.

A handwritten signature in black ink that reads "Gunnip & Company LLP". The signature is written in a cursive, flowing style.

April 12, 2013

State of Delaware
Delaware Water Pollution Control Revolving Loan Fund

Management's Discussion and Analysis

As management of the Delaware Water Pollution Control Revolving Loan Fund (the 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, 2012. 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 2012, the Delaware Department of Natural Resources and Environmental Control (DNREC) was awarded a federal capitalization grant for \$7,222,000 from the U.S. Environmental Protection Agency (EPA). As of June 30, 2012, DNREC has received federal capitalization grants in an aggregate amount of \$172,026,334 since the inception of the Fund. As of June 30, 2012, the State of Delaware has provided state match funds of \$30,557,447 since the inception of the Fund. The combined total capitalization amount at June 30, 2012 was \$202,583,781 since the inception of the Fund. 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.

The Fund realized operating income of \$1,071,051 in fiscal year 2012, which represents an increase of \$807,191, or 306%, from fiscal year 2011. Grants drawn down from federal and state governments totaled \$6,934,861 in fiscal year 2012, a 74% decrease from fiscal year 2011. The decrease in grants drawn down was due to the fact that American Recovery and Reinvestment Act (ARRA) grant funds were primarily expended during fiscal year 2011. 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 ARRA Grant in the amount of \$19,239,100 plus the Annual Grant award increased to \$10,005,909.

Operating revenues for the year ended June 30, 2012 (including interest income on loans) increased \$476,245 or 13% from the previous year. Operating revenues for the year ended June 30, 2011 (including interest income on loans) increased \$561,067 or 19% from the previous year.

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Management's Discussion and Analysis

Loans disbursements made totaled \$9,310,118 during the fiscal year 2012, which represents a decrease of \$51,284,912 or 85% from fiscal year 2011. The decrease in loan disbursements is due to the fact that ARRA grant awards were primarily expended during fiscal year 2011. Loan collections totaled \$18,813,832 during fiscal year 2012 which represents an increase of \$10,757,430 or 134% increase from 2011 primarily because of one large payment from one borrower.

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.

Statements of Fund Net Assets

The following schedule summarizes the statements of net assets (thousands of dollars) of the Fund as of June 30, 2012, 2011 and 2010:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Assets			
Current assets			
Cash and cash equivalents	\$ 56,440	\$ 41,060	\$ 65,362
Grants receivable	3,492	1,174	2,874
Administrative fees receivable	455	334	210
Interfund receivable	769	828	885
Interest receivable	305	337	209
Loans receivable, current	<u>11,696</u>	<u>12,048</u>	<u>10,093</u>
	73,157	55,781	79,633
Noncurrent assets			
Loans receivable, less current portion	<u>151,608</u>	<u>168,640</u>	<u>117,702</u>
Total assets	<u>\$ 224,765</u>	<u>\$ 224,421</u>	<u>\$ 197,335</u>

State of Delaware
Delaware Water Pollution Control Revolving Loan Fund

Management's Discussion and Analysis

Statements of Fund Net Assets (continued)

Liabilities and net assets			
Current liabilities			
Vouchers payable	\$ 5,100	\$ 3,358	\$ 3,004
Deferred income	-	-	40
Interfund payable	<u>769</u>	<u>828</u>	<u>885</u>
Total liabilities	5,869	4,186	3,929
Net assets - unrestricted	<u>218,896</u>	<u>220,235</u>	<u>193,406</u>
Total liabilities and net assets	<u>\$224,765</u>	<u>\$224,421</u>	<u>\$197,335</u>

The combined total net assets of the Fund for the year ended June 30, 2012 decreased by \$1,339,008 or 1% from the fiscal year ended June 30, 2011, which increased by \$26,829,043 or 14% from the fiscal year ended June 30, 2010.

Cash and cash equivalents increased \$15,380,677 or 37% to \$56,440,434 during fiscal 2012 primarily because of an increase in loan collections over the prior year.

Cash and cash equivalents decreased \$24,302,046 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 the prior fiscal year, but not actually paid until the following fiscal year. The increase 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, 2012, 2011 and 2010:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Operating revenues			
Interest income on loans	\$ 1,921	\$ 1,660	\$ 1,348
Administrative fee revenue	2,098	1,882	1,633
Application fees	1	1	1
Other income	<u>1</u>	<u>1</u>	<u>1</u>
	<u>4,021</u>	<u>3,544</u>	<u>2,983</u>

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Management's Discussion and Analysis

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

Operating Expenses			
Reimbursable expenditures under operating grants			
Personnel costs	\$ 1,318	\$ 1,220	\$ 1,103
Travel	10	16	9
Contractual services	629	571	167
Supplies	23	29	32
Other expenses	94	352	78
Grants made	<u>876</u>	<u>1,092</u>	<u>1,155</u>
Total operating expenses	<u>2,950</u>	<u>3,280</u>	<u>2,544</u>
Operating income	1,071	264	439
Nonoperating revenues			
Interest income on deposits	268	341	584
Contributions, EPA	5,982	24,240	9,325
Contributions, State	953	1,984	433
Contributions, Revolving Loan Fund	-	-	655
Loan Forgiveness	<u>(9,613)</u>	<u>-</u>	<u>-</u>
	<u>(2,410)</u>	<u>26,565</u>	<u>10,997</u>
Change in net assets	(1,339)	26,829	11,436
Net assets - beginning	<u>220,235</u>	<u>193,406</u>	<u>181,970</u>
Net assets - ending	<u>\$ 218,896</u>	<u>\$ 220,235</u>	<u>\$ 193,406</u>

The Fund reported operating revenues of \$4,020,722 during fiscal year 2012, which represents an increase of \$476,245 or 13% from fiscal year 2011. The Fund reported operating revenues of \$3,544,477 during fiscal year 2011, which represents an increase of \$561,067 or 19% from fiscal year 2010. 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 decrease of \$1,339,008 in total fund net assets for the fiscal year ended June 30, 2012, and an overall increase of \$26,829,043 in total net assets for the fiscal year ended June 30, 2011.

Federal grant revenue decreased by \$18,258,753 or 75% during fiscal year 2012, as a result of decreased loan disbursements and the fact that ARRA funds were primarily expended during fiscal year 2011. The State match decreased by \$1,031,024, or 52%.

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Management's Discussion and Analysis

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 overall loan disbursements.

Total operating expenses decreased \$330,946 or 10% during fiscal 2012, due to a decrease in both grants and other expenses paid out of the Federal Administrative Fund. Total operating expenses increased \$735,850 or 29% during fiscal year 2011, due to an increase in grants paid out of the Nonfederal Administrative Fund and additional personnel costs and other expenses paid out of the Federal Administrative Fund.

Total nonoperating expenses in 2012 represent the Fund's forgiveness of ARRA loans during fiscal year 2012 for completed projects. 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.

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:

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

State of Delaware
Delaware Water Pollution Control Revolving Loan Fund

Statements of Fund Net Assets

June 30, 2012 and 2011

	2012				2011			
	Federal Administrative Fund	Capital Reserve Loan Fund	Nonfederal Administrative Fund	Total	Federal Administrative Fund	Capital Reserve Loan Fund	Nonfederal Administrative Fund	Total
Assets								
Current assets								
Cash and cash equivalents	\$ -	\$ 48,342,509	\$ 8,097,925	\$ 56,440,434	\$ 1,128	\$ 32,567,679	\$ 8,490,950	\$ 41,059,757
Grants receivable	-	3,491,996	-	3,491,996	-	1,174,691	-	1,174,691
Administrative fees receivable	-	-	454,990	454,990	-	-	333,946	333,946
Interfund receivable	-	-	769,139	769,139	-	-	827,725	827,725
Interest receivable	-	305,112	-	305,112	-	337,006	-	337,006
Loans receivable - current	-	11,695,963	-	11,695,963	-	12,047,528	-	12,047,528
	-	63,835,580	9,322,054	73,157,634	1,128	46,126,904	9,652,621	55,780,653
Noncurrent assets								
Loans receivable - less current portion	-	151,607,963	-	151,607,963	-	168,585,730	54,442	168,640,172
	-	-	-	-	-	-	-	-
Total assets	<u>\$ -</u>	<u>\$ 215,443,543</u>	<u>\$ 9,322,054</u>	<u>\$ 224,765,597</u>	<u>\$ 1,128</u>	<u>\$ 214,712,634</u>	<u>\$ 9,707,063</u>	<u>\$ 224,420,825</u>
Liabilities and net assets								
Current liabilities								
Vouchers payable	\$ -	\$ 5,093,552	\$ 6,646	\$ 5,100,198	\$ -	\$ 3,357,832	\$ -	\$ 3,357,832
Deferred income	-	-	-	-	-	-	-	-
Interfund payable	-	769,139	-	769,139	-	827,725	-	827,725
Total liabilities	-	5,862,691	6,646	5,869,337	-	4,185,557	-	4,185,557
Net assets - unrestricted	-	209,580,852	9,315,408	218,896,260	1,128	210,527,077	9,707,063	220,235,268
Total liabilities and net assets	<u>\$ -</u>	<u>\$ 215,443,543</u>	<u>\$ 9,322,054</u>	<u>\$ 224,765,597</u>	<u>\$ 1,128</u>	<u>\$ 214,712,634</u>	<u>\$ 9,707,063</u>	<u>\$ 224,420,825</u>

See notes to financial statements.

State of Delaware
Delaware Water Pollution Control Revolving Loan Fund

Statements of Revenues, Expenses, and Changes in Fund Net Assets

For the Years Ended June 30, 2012 and 2011

	2012				2011			
	Federal Administrative Fund	Capital Reserve Loan Fund	Nonfederal Administrative Fund	Total	Federal Administrative Fund	Capital Reserve Loan Fund	Nonfederal Administrative Fund	Total
Operating revenues								
Interest income on loans	-	1,921,141	-	\$ 1,921,141	-	1,660,407	-	\$ 1,660,407
Administrative fee revenue	-	-	2,097,594	2,097,594	-	-	1,881,890	1,881,890
Application fees	-	667	-	667	-	-	681	681
Other income	-	1,320	-	1,320	-	1,499	-	1,499
	-	1,923,128	2,097,594	4,020,722	-	1,661,906	1,882,571	3,544,477
Operating expenses								
Reimbursable expenditures under operating grants								
Personnel costs	389,801	-	928,473	1,318,274	470,574	-	749,510	1,220,084
Travel	1,272	-	8,191	9,463	-	-	15,784	15,784
Contractual services	2,167	579	626,619	629,365	3,982	46	566,541	570,569
Supplies and office expenses	-	-	22,781	22,781	-	-	29,373	29,373
Other expenses	17,476	-	76,229	93,705	59,764	(585)	293,252	352,431
Grants made	-	-	876,083	876,083	-	-	1,092,376	1,092,376
Total operating expenses	410,716	579	2,538,376	2,949,671	534,320	(539)	2,746,836	3,280,617
Operating income (loss)	(410,716)	1,922,549	(440,782)	1,071,051	(534,320)	1,662,445	(864,265)	263,860
Nonoperating revenues and expenses								
Interest income on deposits	-	218,933	49,127	268,060	-	284,610	55,935	340,545
Contributions - EPA	341,998	5,639,525	-	5,981,523	528,109	23,712,167	-	24,240,276
Contributions - State	67,590	885,748	-	953,338	6,211	1,978,151	-	1,984,362
Contributions - Revolving Loan Fund	-	-	-	-	-	-	-	-
Loan Forgiveness	-	(9,612,980)	-	(9,612,980)	-	-	-	-
Transfers	-	-	-	-	-	-	-	-
	409,588	(2,868,774)	49,127	(2,410,059)	534,320	25,974,928	55,935	26,565,183
Change in net assets	(1,128)	(946,225)	(391,655)	(1,339,008)	-	27,637,373	(808,330)	26,829,043
Net assets - beginning - unrestricted	1,128	210,527,077	9,707,063	220,235,268	1,128	182,889,704	10,515,393	193,406,225
Net assets - ending - unrestricted	\$ -	\$209,580,852	\$9,315,408	\$218,896,260	\$ 1,128	\$ 210,527,077	\$9,707,063	\$ 220,235,268

See notes to financial statements.

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

Statements of Cash Flows

For the Years Ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Cash flows from operating activities		
Loan collections	\$ 18,813,832	\$ 8,056,402
Interest received from borrowers	1,953,035	1,532,700
Administrative fee revenue	1,976,550	1,757,626
Application fees and other revenue	1,987	2,180
Loan disbursements	(9,310,118)	(60,595,030)
General expenses paid	<u>(2,940,221)</u>	<u>(3,319,984)</u>
Net cash provided by (used in) operating activities	10,495,065	(52,566,106)
Cash flows from noncapital financing activities		
Grants received from EPA	4,072,939	25,623,921
State portion funded by recipient	<u>544,613</u>	<u>2,299,593</u>
Net cash provided by noncapital financing activities	4,617,552	27,923,514
Cash flows from investing activities		
Interest on deposits	<u>268,060</u>	<u>340,545</u>
Net cash provided by investing activity	<u>268,060</u>	<u>340,545</u>
Net increase (decrease) in cash and cash equivalents	15,380,677	(24,302,047)
Cash and cash equivalents - beginning of the year	<u>41,059,757</u>	<u>65,361,804</u>
Cash and cash equivalents - end of the year	<u>\$ 56,440,434</u>	<u>\$ 41,059,757</u>
Reconciliation of net operating income to cash used by operating activities		
Cash flows from operating activities		
Operating income	\$ 1,071,051	\$ 263,860
Adjustments to reconcile operating income to net cash provided by (used in) operating activities		
Administrative fees receivable	(121,044)	(124,265)
Interest receivable	31,894	(127,707)
Loans receivable	7,770,799	(52,892,926)
Vouchers payable	1,742,365	354,298
Increase (decrease) in deferred income	<u>-</u>	<u>(39,366)</u>
Net cash provided by (used in) operating activities	<u>\$ 10,495,065</u>	<u>\$ (52,566,106)</u>
Schedule of noncash investing activities		
Loan forgiveness	<u>\$ (9,612,980)</u>	<u>-</u>

See notes to financial statements.

State of Delaware
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Notes to Financial Statements

Note A - Summary of Significant Accounting Policies

This summary of significant accounting policies of the Delaware Water Pollution Control Revolving Loan Fund (the Fund) 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.

1. 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 (SRF) federal assistance program. The Fund's enabling legislation empowers the Department of Natural Resources and Environmental Control (DNREC) to administer the Fund.

2. 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 (the State) that are attributable to the transactions of the Fund.

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 Nonfederal Administrative Fund, which accounts for monies that the 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 CFR Part 35 Guidance on Fees Charged by State to Recipients of Clean Water State Revolving Fund Program Assistance.

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Delaware Water Pollution Control Revolving Loan Fund

Notes to Financial Statements (Continued)

3. 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.

4. 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.

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. Nonoperating revenues include those from noncapital financing and investing activities.

5. Cash Equivalents

Cash and cash equivalents typically consist of demand deposits, short-term money market funds and other deposits with a maturity of three months or less when purchased.

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Notes to Financial Statements (Continued)

6. 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.

Note B - Cash and Cash Equivalents

Cash and Cash Equivalents -- Held by the State Treasurer

Cash and cash equivalents as reported on the statement of net assets represent 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.

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.

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Notes to Financial Statements (Continued)

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:

- 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.

Since the funds cash accounts are managed by the Treasurer, the fund is unable to control compliance with the collateralization requirements or determine if these requirements have been met.

The Policy is available on the Office of the State Treasurer website (<http://treasury.delaware.gov/>).

Cash – Federal Administrative Fund

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.

Cash – Capital Reserve Loan Fund

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 – Administrative Fees

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

State of Delaware
Delaware Water Pollution Control Revolving Loan Fund

Notes to Financial Statements (Continued)

Note C - Loans Receivable

The loans receivable account is made up of the following major categories for the years ended June 30:

	<u>2012</u>	<u>2011</u>
Municipal loans		
Sussex County Council	\$ 60,339,800	\$ 56,712,680
City of Wilmington	8,329,001	9,404,996
City of Seaford	5,915,714	5,170,642
Kent County	23,068,320	24,041,879
City of Milford	1,964,820	1,996,221
New Castle County	2,362,165	293,097
Town of Selbyville	2,349,239	2,495,042
Town of Laurel	3,419,663	3,690,013
City of Dover	6,011,963	5,280,378
Camden Wyoming Sewer & Water Authority	195,642	213,786
Town of Millsboro	12,268,721	7,584,546
Town of Bridgeville	2,537,634	2,585,382
City of Lewes	10,591,808	11,167,326
Inland Bays	-	1,810,669
Town of Delmar	1,235,695	1,655,688
North Millville	-	4,476,991
Town of Georgetown	4,735,653	4,738,922
City of Harrington	3,192,675	3,192,675
Rehoboth Bay Conservancy	-	1,966,811
Dewey Beach	450,000	-
Town of Middletown	260,000	-
Town of Smyrna	<u>1,871,798</u>	<u>-</u>
Total municipal loans	<u>151,100,311</u>	<u>148,477,744</u>

State of Delaware
Delaware Water Pollution Control Revolving Loan Fund

Notes to Financial Statements (Continued)

ARRA loans		
Sussex County Council	\$ 6,834,025	\$ 25,725,489
New Castle Conservation District	-	2,559,862
Town of Millsboro	-	125,000
Challenge Program	-	190,000
Town of Smyrna	-	1,162,018
City of New Castle	661,250	-
Kent County	<u>627,659</u>	<u>-</u>
Total ARRA loans	<u>8,122,934</u>	<u>29,762,369</u>
Septic Rehabilitation Program	3,382,801	1,477,352
Agriculture Nonpoint Source Loans	536,610	809,176
Dairy Loan Program	50,600	79,768
Underground Storage Tank Program	41,939	81,291
Expanded Agriculture Loan Program	<u>68,731</u>	<u>-</u>
Total loans	<u>\$163,303,926</u>	<u>\$180,687,700</u>
Current portion	\$ 11,695,963	\$ 12,047,528
Long-term portion	<u>151,607,963</u>	<u>168,640,172</u>
Total loans	<u>\$163,303,926</u>	<u>\$180,687,700</u>

Interest charged on these loans ranges from 0% to 6.0% for both 2012 and 2011. 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, 2012 and 2011, as there were no material delinquent loan balances or loan defaults during the year. During 2012, several loan balances were forgiven as part of the terms of the loan agreements. Total loans forgiven in 2012 were \$9,612,980. There are no further loan balances eligible for forgiveness as of June 30, 2012.

State of Delaware
Delaware Water Pollution Control Revolving Loan Fund

Notes to Financial Statements (Continued)

Note D - 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, 2012) were \$202,583,781, which includes the federal portion of \$172,026,334, or five-sixths, and the state matching portion of \$30,557,447, 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 A, a separate Administrative Fund is used to account for such costs and related revenues.

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, 2012	\$172,026,334	\$30,557,447	\$202,583,781
Awards expended through June 30, 2012	\$167,331,673	\$29,618,515	\$196,950,188

Note E - Pension Plan

Employees of the Fund are considered employees of the State and are covered under the State Employees' Pension Plan. Total pension cost of \$95,695 for 2012 and \$61,466 for 2011 is included in the financial statements as personnel costs.

Detailed information regarding this plan is available in the Delaware Code and the Rules and Regulations of the Board of Pension Trustees. Certain significant plan provisions include:

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

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

Notes to Financial Statements (Continued)

Post-2011 Employee - Post-2011 employee shall mean an employee, as defined in 29 Del C., c. 55 Section 5501(e), who is first employed by the State on or after January 1, 2012.

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.

For Post-2011 employees, final average compensation per House Bill 81 shall include:

1. 1/36 of the compensation, minus overtime payments, paid to an employee during any period of 36 consecutive months or any 36 months comprised of three periods of 12 consecutive months in that employee's years of service credited under paragraphs (d)(1), (2), and #3 of this section in which that employee's compensation was highest, or the average monthly compensation paid to an employee during that period if such period is less than 36 months, plus
2. The dollar amounts of awards received under the "Teacher of the Year" and "Delaware Award for Excellence and Commitment in State Service" programs, plus
3. The total dollar amount of final lagged payments for credited service received by employees as defined under Section 2712 of Title 29.

Vesting - Five (5) years of credited service. For Post-2011 employees, ten 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.

For Post-2011 employees, age 65 with ten years of credited service, exclusive of service credited under 29 Del C. § 5501(d) (12); age 60 with 20 years of credited service, exclusive of service credited under 29 Del C. § 5501(d) (12); 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 this plan opted into a disability insurance program offered by the State effective January 1, 2006.

State of Delaware
Delaware Water Pollution Control Revolving Loan Fund

Notes to Financial Statements (Continued)

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

Contributions - Employer - 3% of earnings in excess of \$6,000. For Post-2011 employees, 5% of earnings in excess of \$6,000.

Death Benefit - \$7,000 per member.

The State does not maintain the Plan information by agency, and therefore, the Fund's portion of the Plan's net assets available for benefits, percentage of annual pension cost contributed, and the actuarial present value of vested and nonvested accumulated plan benefits is not readily available.

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.

Note F - Commitments and Contingencies

1. Operating Lease

Beginning July 1, 1997, DNREC entered into a lease for office space, on behalf of the Fund, of which the Fund currently pays 100%. The operating lease is renewed annually on a fiscal year basis, and currently expires June 30, 2013. Rent expense, which is included in the financial statements as contractual services, was \$47,883 in 2012 and \$47,001 in 2011.

2. Loan Commitments

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, 2012, there were binding commitments of \$10,190,207.

3. Cost Reimbursement Contracts

The Fund derives all of its nonoperating 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. Management does not believe there are any adjustments that could arise from disallowed costs that would materially impact the Fund's financial statements.

State of Delaware
Delaware Water Pollution Control Revolving Loan Fund

Notes to Financial Statements (Continued)

Note G - Risk Management

The Fund is insured under the State'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, 2012, there were no outstanding or pending claims against the Fund.

Note H - 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 (ARRA) 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. During fiscal year 2012, the Fund forgave \$9,612,980 in ARRA loans.

State of Delaware
Delaware Water Pollution Control Revolving Loan Fund

Notes to Financial Statements (Continued)

Note I - Nonfederal Administrative Fund

The Nonfederal Administrative fund account is used to supplement administrative expenses of the Fund and other water quality improvement expenses.

The Nonfederal 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.

During the fiscal year ended June 30, 2012, the Nonfederal Administrative Fund funded the following:

SEFO grants	\$ 876,083
Personnel costs for other water quality areas	<u>525,481</u>
Total	\$ <u>1,401,564</u>

Note J - Subsequent Events

Events and transactions subsequent to year end have been evaluated for potential recognition in the financial statements or disclosure in the notes to the financial statements. All events and transactions have been evaluated through the date of the auditors' report, which is the date the financial statements were available to be issued.

In June 2012, the Department of Public Health requested that \$27,050,177 in grant award funds from Drinking Water State Revolving Loan Fund (DWSRF) be deobligated from the DWSRF and transferred to the Fund.

On September 4, 2012, the EPA deobligated this amount from the DWSRF's grant award and awarded the funds to the Fund.

In addition, on December 18, 2012, the DWSRF transferred \$5,410,035 in State match funds directly to the Fund.

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, 2012 and have issued our report thereon dated February 26, 2013. 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.

However, we identified a deficiency in internal control over financial reporting, described as 12-01 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 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, this report is a public record and its distribution is not limited.

Gunnip + Company LLP

April 12, 2013

State of Delaware
Delaware Water Pollution Control Revolving Loan Fund

Schedule of Findings and Responses

Current Year Finding:

Finding 12-01:

Condition:

Similar to the prior year, there were a number of adjustments that were required to be made as part of the audit.

Because of some lingering issues from fiscal year 2011 conversion to the State's new accounting system, First State Financials (FSF), the entries proposed by the Fund's predecessor auditors and turnover in the accounting area, there were still some adjustments necessary to ensure the Fund's Peachtree accounts were properly reflective of an accrual basis of accounting.

The new accountant was able to properly reconcile the FSF activity to Peachtree for fiscal year 2012, but did not have the detailed support to ensure that the entries proposed by the predecessor auditor were properly incorporated into the net asset balances being brought forward to fiscal year 2012.

Criteria:

Proper internal control procedures require that the Fund's general ledger and corresponding Peachtree detail proper reflect the entries proposed by the predecessor auditor to ensure that Fund's net asset balances are reconciled to the Fund's audited financial statements and current activity has been properly recorded.

Cause:

Based on turnover in the accounting area, the predecessor auditors proposed entries were not properly reflected in the Fund's general ledger.

Effect:

A number of accounts in the Peachtree General Ledger did not properly reflect the entries proposed by the predecessor auditor and those entries and related general ledger accounts had to be analyzed and subsequently adjusted.

Recommendation:

We recommend that DNREC ensure it properly understands all proposed entries booked to the Fund's financial statements and ensure that such entries are in turn properly reflected in the Fund's Peachtree general ledger, as necessary.

State of Delaware
Delaware Water Pollution Control Revolving Loan Fund

Schedule of Findings and Responses

Management's Response:

Management for the Delaware Water Pollution Control Revolving Fund (WPCRF) have reviewed Audit Finding 12-01, and offer the following comments and corrective action plan that have already been implemented.

It is acknowledged that a number of adjustments were required for the FY 2012 audit due to issues associated with the conversion to the State's new accounting system; entries proposed by the Fund's predecessor auditor; and turnover in WPCRF accounting staff

Implemented Corrective Action Plan

The State's new accounting system has been successfully implemented, and appropriate accounting staffs for the WPCRF have received all necessary training. In 2012, DNREC hired an Accountant for the WPCRF that has state accounting training and experience, and working knowledge and experience with general ledger and proprietary fund accounting. This person is responsible for monthly reconciliation of all WPCRF accounts and records, and providing monthly reconciliation reports to the WPCRF Administrator. All accounting adjustments recommended by auditors for the WPCRF are reviewed by the program Accountant, Fund Administrator, and appropriate staff prior to acceptance.

Prior Year Findings:

Carried forward as a current year finding.