

**State of Delaware Drinking Water Revolving Loan Fund
Financial Statements
June 30, 2012 and 2011**

Report Issued: April 22, 2013

Table of Contents

Independent Auditors' Report.....	1
Management's Discussion and Analysis	3
Financial Statements	
Statements of Net Assets	6
Statements of Revenues, Expenses, and Changes in Net Assets.....	7
Statements of Cash Flows.....	8
Notes to Financial Statements	9
Supplemental Information	
Schedules of Fund Net Assets By Fund.....	24
Schedules of Revenues, Expenses, and Changes in Fund Net Assets By Fund.....	26
Schedules of Fund Net Assets By Classification.....	28
Schedules of Revenues, Expenses, and Changes in Fund Net Assets By Classification	29
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.....	30
Schedule of Findings and Responses	32
Summary Schedule of Prior Audit Findings	34

Zelenkofske Axelrod LLC

Independent Auditors' Report

To the Office of Auditor of Accounts
Dover, DE

We were engaged to audit the accompanying Statements of Net Assets of the State of Delaware Drinking Water Revolving Loan Fund ("Fund") as of June 30, 2012, and the related Statements of Revenue, Expenses and Changes in Fund Net Assets, and Statements of Cash Flows and the related notes for the years then ended. These financial statements are the responsibility of the State's management. The financial statements of the Fund as of June 30, 2011, were audited by other auditors whose report dated June 8, 2012, expressed an unqualified opinion on those financial statements.

We were unable to confirm beginning or ending cash balances, as separate account balances are not maintained by the State which is stated in the accompanying financial statements at \$25,247,577 as of June 30, 2012. The cash balances directly relate to the receivables, the unearned revenues, the net assets, the statements of revenues, expenses, and changes in net assets, the statements of cash flows, and the related notes to the financial statements. The Fund's records do not permit the application of other auditing procedures to cash balances.

Since the Fund is not able to identify cash balances and we were not able to apply other auditing procedures to satisfy ourselves as to cash balances, receivables, the unearned revenues, the net assets, and the related revenues, expenses, cash flows, and notes, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on these financial statements.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated April 8, 2013, on our consideration of the State of Delaware Drinking Water Revolving Loan 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.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 2 through 4 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We were unable to apply certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America as noted in the second paragraph.

Harrisburg

830 Sir Thomas Court, Suite 100
Harrisburg, PA 17109
717.561.9200 Fax 717.561.9202

Lehigh Valley

1101 West Hamilton Street
Allentown, PA 18101-1043
610.871.5077 Fax 717.561.9202

Philadelphia

2370 York Road, Suite A-5
Jamison, PA 18929
215.918.2277 Fax 215.918.2302

Pittsburgh

800 McKnight E. Drive, Suite 3805
Pittsburgh, PA 15237
412.367.7102 Fax 412.367.7103

Zelenkofske Axelrod LLC

We were engaged for the purpose of forming opinions on the financial statements that collectively comprise the State of Delaware Drinking Water Revolving Loan Fund financial statements as a whole. The Schedules of Fund Net Assets by Fund, Schedules of Revenues, Expenses and Changes in Fund Net Assets by Fund, Schedules of Fund Net Assets by Classification, Schedules of Revenues, Expenses and Changes in Fund Net Assets by Classification are presented for purposes of additional analysis and are not a required part of the financial statements. Because of the significance of the matter described in the second paragraph, it is inappropriate to and we do not express an opinion on the supplementary information referred to above.

Zelenkofske Axelrod LLC

ZELENKOFKSKE AXELROD LLC

Harrisburg, PA
April 8, 2013

**State of Delaware Drinking Water Revolving Loan Fund
Management's Discussion and Analysis
June 30, 2012 and 2011**

As management of the State of Delaware Drinking Water 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

The Fund was established through subsection 15 of 29 Del. C., c. 79, and provides financial assistance to eligible public water systems in Delaware for the planning, design and construction of drinking water facilities as well as loans for land acquisition for source water protection purposes. The Fund is funded through federal capitalization grants as established under Section 1452 of the Safe Drinking Water Act (the Act). The Act requires the State of Delaware (the State) to provide matching funds equal to 20% of federal funds received.

The Fund is administered by the State, Delaware Department of Health and Social Services (DHSS), Division of Public Health (DPH) under the supervision of the Governor's Cabinet Committee on State Planning Issues. DPH's primary activities include making loans, providing direct assistance, and managing the Fund to meet the objectives of the Act.

The Fund consists of five sub-funds, each of which is considered a separate accounting entity. The primary activity of the Loan Fund is the issuance of loans. The four set-aside sub-funds are used to account for the proceeds of specific grant revenues that are legally restricted to expenditures for specific purposes.

The Fund's activities are accounted for as a distinct operating unit within the DPH. Accordingly, the financial statements of the Fund are intended to present the financial position and the results of operations of only that portion of the funds of the State that is attributable to the transactions of the Fund.

The Fund is accounted for as an enterprise fund. The accrual basis of accounting is utilized in enterprise funds. Revenue is recognized when earned and expenses are recognized when the liability is incurred.

Financial Highlights (numbers in thousands)

The Fund realized a change in net assets of \$14,184.4 in fiscal year 2012, which represents an increase of 6.4% from the change in net assets of \$13,329.3 in fiscal year 2011, due to increased loan disbursements activity, resulting in an increase in grants received from the EPA. The Fund realized a change in net assets of \$13,329.3 in fiscal year 2011, which represents a decrease of 7.0% from the change in net assets of \$14,333.0 in fiscal year 2010. The increase in net assets in 2011 was due to increased loan activity, which includes funding from the American Recovery and Reinvestment Act (ARRA) for special projects.

Grant revenue recognized from the federal and state governments totaled \$15,111.3 in fiscal year 2012, a 12.8% decrease from fiscal year 2011, due to decreased state match revenues, and a decrease in ARRA activity for special projects. Grant revenue recognized from the federal and state governments totaled \$17,320.1 in fiscal year 2011, a (13.6)% decrease from fiscal year 2010, largely due to decreased disbursements from ARRA for special projects.

Loans made totaled \$15,684.6 during this fiscal year, which represents an increase of \$1,453.4 from the previous year. This increase of 10.2% was caused by increased draws on existing loans from municipalities and others through the State. Loans made during 2011 totaled \$14,231.2, which represents an increase of \$1,187.8 from the previous year. This increase of 9.1% was caused by increased draws on existing loans from municipalities and others through the State.

Loan collections (principal) totaled \$3,182.6 during this fiscal year. This represents an overall increase of \$1,931.8, 154.4%, from the prior year due to the timing of receipt of a late payment on a loan, due in prior year and not paid until 2012, and due to the completion of additional projects. Loan collections (principal) totaled

\$1,250.8 during fiscal year 2011. This represents an overall decrease of \$(330.7), (20.9)%, from the prior year because of late payments from a borrower.

Statement of Net Assets

The total net assets of the Fund for years ended June 30, 2012 and 2011 increased by \$14,184.4 and \$13,329.3, respectively. The following condensed statement of net assets (Table 1) shows a summary of changes in dollars.

During fiscal year 2012, cash increased approximately \$4,407.4, 21.1%, to \$25,247.6 based on an increase in loan repayments, grants received from the EPA, as well as loan origination and administration fees received. Loans receivable increased by \$10,588.2, 13.2%, to \$91,085.8, mostly as a result of increased draws on existing loans from municipalities. Federal grants receivable decreased by approximately \$1,638.8, 90.5%, mostly due to the timing of reimbursements requests from the Environmental Protection Agency (EPA) during the fiscal year ended June 30, 2012.

During fiscal year 2011, cash decreased approximately \$(229.7), (1.1)%, to \$20,840.2 based on a decrease in loan repayments and loan origination fees received. Loans receivable increased by \$14,387.5, 21.8%, to \$80,497.6, mostly as a result of the issuance of one new loan and more draws on six existing loans. Federal grants receivable increased by approximately \$1,783.8, 6,808.4%, mostly due to the timing of reimbursements requests from the EPA during fiscal year ended June 30, 2011.

Table 1
Statement of Net Assets
(Thousands of Dollars)

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Current Assets			
Cash and cash equivalents	\$25,247.6	\$20,840.2	\$21,069.9
Loans, current portion	4,379.4	4,225.2	2,157.0
Loan interest	710.5	1,006.6	579.0
Federal grants receivable	171.2	1,810.0	26.2
State grants receivable	<u>-</u>	<u>3,275.0</u>	<u>3,294.1</u>
Total Current Assets	30,508.7	31,157.0	27,126.2
Noncurrent Assets			
Loans, net of current portion	<u>86,706.4</u>	<u>76,272.4</u>	<u>63,953.1</u>
Total Assets	<u>\$117,215.1</u>	<u>\$107,429.4</u>	<u>\$91,079.3</u>
Current Liabilities			
Federal grants payable	\$ 114.5	\$ 2,028.3	\$ -
State advances	<u>-</u>	<u>-</u>	<u>26.2</u>
Total Current Liabilities	114.5	2,028.3	26.2
Noncurrent Liabilities			
Unearned revenue - state match	<u>6,247.3</u>	<u>8,732.3</u>	<u>7,713.6</u>
Total Liabilities	6,361.8	10,760.6	7,739.8
Net Assets - Restricted	<u>110,853.3</u>	<u>96,668.8</u>	<u>83,339.5</u>
Total Liabilities and Net Assets	<u>\$117,215.1</u>	<u>\$107,429.4</u>	<u>\$91,079.3</u>

Vouchers payable decreased by \$1,913.8, or 94.4% from the prior year as a result of a delay in approval of disbursements at year-end for 2011. Vouchers payable in 2011 increased by \$2,002.1 over 2010 for the same reason.

Unearned revenue from the State match decreased by \$2,485.0, 28.5%, as the State drew down its match to fund loan disbursements to sub-recipients during the fiscal year and the match for the 2008 grant year being made by nonfederal administration funds rather than 21st Century funds. In 2011, unearned revenue from the State match increased by \$1,018.7, 13.2%, as the State drew down its match to fund loan disbursements to sub-

recipients during the fiscal year. This was partially offset by a new grant from the EPA, which required a match that was deposited into the Fund.

Statement of Revenue, Expenses, and Changes in Net Assets (numbers in thousands)

The following schedule summarizes the statement of revenue, expenses, and changes in net assets of the Fund for the fiscal years ended June 30, 2012, 2011, and 2010.

Federal grant revenue decreased \$(1,233.7), 7.9%, and State match revenue decreased by \$(975.1), 57.5%, during fiscal year 2012 due to the 2008 grant year State match being made from nonfederal administrative funds rather than 21st Century funds. In 2011, federal grant revenue decreased by \$(2,860.8), 15.5%, but the State match revenue increased by \$128.3, 8.2%. There was a decrease in drawdowns from the ARRA funded loans, which do not require a state match. Additionally, there was an increase in drawdowns from base loans, which do not require a state match.

Interest income from cash deposits decreased by \$(63.5), 32.2%, during fiscal year 2012 and \$11.4, 5.5%, during fiscal year 2011, due mainly to decreases in interest rates (see Note B).

Operating expenses increased by approximately \$147.9, 6.4%, due mainly to increased personnel costs (salaries and related benefits), offset by a decrease in contractual services. In 2011, operating expenses decreased approximately \$(197.4), 7.9%, due primarily to early completion of subgrant projects.

Table 2
Statement of Revenue, Expenses, and Changes in Net Assets
(Thousands of Dollars)

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Operating Revenue			
Interest income - loans and administrative fees	\$ 2,509.0	\$ 1,313.6	\$ 1,889.8
Loan origination fees	89.3	50.0	20.9
Grant revenue	14,390.4	15,624.1	18,484.9
ARRA loan forgiveness	(1,183.4)	(3,240.0)	(5,329.9)
Write off of receivables	(16.0)	-	-
State match	<u>720.9</u>	<u>1,696.0</u>	<u>1,567.7</u>
Total Operating Revenue	16,510.2	15,443.7	16,633.4
Operating Expenses			
Salaries and related benefits	927.9	704.3	608.9
Contract services	534.2	779.8	943.7
Indirect costs	45.5	51.8	52.1
Subgrants	828.0	722.7	859.6
Supplies	55.0	40.5	30.1
Equipment	3.8	-	14.1
Travel	15.5	10.6	6.9
Training	<u>49.8</u>	<u>2.1</u>	<u>(6.1)</u>
Total Operating Expenses	<u>2,459.8</u>	<u>2,311.9</u>	<u>2,509.3</u>
Operating Income	14,050.4	13,131.8	14,124.1
Nonoperating Revenue			
Interest income - cash deposits	<u>134.0</u>	<u>197.5</u>	<u>208.9</u>
Total Nonoperating Revenue	<u>134.0</u>	<u>197.5</u>	<u>208.9</u>
Change In Net Assets	14,184.4	13,329.3	14,333.0
Net Assets - Beginning Of Year	<u>96,668.8</u>	<u>83,339.5</u>	<u>69,006.3</u>
Net Assets - End Of Year	<u>\$110,853.2</u>	<u>\$96,668.8</u>	<u>\$83,339.5</u>

State Of Delaware Drinking Water Revolving Loan Fund
 Statements Of Net Assets
 June 30, 2012 and 2011

	2012	2011
Assets		
Current Assets:		
Cash and cash equivalents	\$ 25,247,577	\$ 20,840,154
Loans receivable	4,379,384	4,225,250
Interest receivable	710,484	1,006,607
Federal grants receivable	171,214	1,810,004
State grants receivable	-	3,275,000
Total Current Assets	30,508,659	31,157,015
Noncurrent Assets:		
Loans receivable	86,706,383	76,272,361
Total Assets	\$ 117,215,042	\$ 107,429,376
Liabilities		
Current Liabilities:		
Vouchers payable	\$ 114,514	\$ 2,028,286
Total Current Liabilities	114,514	2,028,286
Noncurrent Liabilities:		
Unearned revenue - state match	6,247,285	8,732,267
Total Liabilities	6,361,799	10,760,553
Net Assets		
Net assets - restricted	110,853,243	96,668,823
Total Liabilities and Net Assets	\$ 117,215,042	\$ 107,429,376

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

State Of Delaware Drinking Water Revolving Loan Fund
 Statements Of Revenues, Expenses, and Changes In Net Assets
 For the Years Ended June 30, 2012 and 2011

	2012	2011
Operating Revenues		
Interest income - loans	\$ 1,254,486	\$ 656,811
Interest income - administrative fees	1,254,486	656,811
Loan origination fees	89,317	50,000
Grant revenue	14,390,389	15,624,128
ARRA loan forgiveness	(1,183,378)	(3,239,959)
Write off of receivables	(16,000)	-
State match	720,891	1,695,957
	16,510,191	15,443,748
Operating Expenses		
Salaries and related benefits	927,945	704,266
Contract services	534,183	779,828
Indirect costs	45,544	51,792
Subgrants	827,954	722,745
Supplies	55,032	40,473
Equipment	3,844	-
Training	49,836	2,200
Travel	15,464	10,597
	2,459,802	2,311,901
Operating Income	14,050,389	13,131,847
Nonoperating Revenues and Expenses		
Interest income - cash accounts	134,031	197,495
	134,031	197,495
Increase in Net Assets	14,184,420	13,329,342
Net Assets - Beginning of Year	96,668,823	83,339,481
Net Assets - End of Year	\$ 110,853,243	\$ 96,668,823

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

State Of Delaware Drinking Water Revolving Loan Fund
 Statements Of Cash Flows
 Years Ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Cash Flow From Operating Activities		
Loan repayments	\$ 3,182,645	\$ 1,250,830
Interest income - loans	1,550,610	886,041
Interest income - administrative fees	1,254,486	-
Loan origination fees	89,317	50,000
Grants received from EPA	14,845,800	11,221,559
Grants received from the State of Delaware	1,494,909	2,733,684
Loan disbursements	(15,684,573)	(14,231,239)
Salaries and related benefits paid	(927,945)	(704,266)
General expenses paid	<u>(1,531,857)</u>	<u>(1,607,636)</u>
Net Cash Provided by (Used in) Operating Activities	4,273,392	(401,027)
Cash Flow From Investing Activity		
Interest received from cash deposits	<u>134,031</u>	<u>197,495</u>
Net cash provided by investing activity	134,031	197,495
Noncapital Financing Activities		
Advances from (repayments to) the State of Delaware	<u>-</u>	<u>(26,176)</u>
Net Cash Used by Noncapital Financing Activities	-	(26,176)
Increase (Decrease) in Cash and Cash Equivalents	4,407,423	(229,708)
Cash and Cash Equivalents - Beginning of Year	<u>20,840,154</u>	<u>21,069,862</u>
Cash and Cash Equivalents - End of Year	<u>\$ 25,247,577</u>	<u>\$ 20,840,154</u>
Reconciliation of Operating Income to Net Cash Used in Operating Activities		
Operating Income	\$ 14,050,389	\$ 13,131,847
Adjustments to reconcile net operating Income to net cash used in operating activities		
Changes in assets and liabilities:		
Increase in loans receivable	(10,588,156)	(14,387,478)
(Increase) decrease in federal grants receivable	1,638,790	(1,783,828)
(Increase) decrease in unearned revenue - state match	(2,484,983)	1,018,643
Decrease in state grants receivable	3,275,000	19,085
(Increase) decrease in interest and dividends receivable	296,124	(427,581)
Increase (decrease) in vouchers payable	<u>(1,913,772)</u>	<u>2,028,285</u>
Net Cash Provided by (Used in) Operating Activities	<u>\$ 4,273,392</u>	<u>\$ (401,027)</u>

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

State of Delaware Drinking Water Revolving Loan Fund
Notes to Financial Statements
Years Ended June 30, 2012 and 2011

Note A - Summary of Significant Accounting Policies

This summary of significant accounting policies of the Drinking Water Revolving Loan Fund (the Fund) is presented to assist in understanding the Fund's financial statements. These accounting policies conform to accounting principles generally accepted in the United States of America and have been consistently applied in the preparation of the financial statements.

1. General Background

The Fund was established through 29 Del. C., c. 79, which provides financial assistance to eligible public water systems in Delaware for the planning, design, and construction of drinking water facilities as well as loans for land acquisition for source water protection purposes. Standard loans made by the Fund must be repaid within 20 to 30 years. All repayments, including interest and principal, must remain in the Fund.

The Fund is administered by the State, Delaware Department of Health and Social Services (DHSS), Division of Public Health (DPH) under the supervision of the Governor's Cabinet Committee on State Planning Issues. DPH's primary activities include making loans, providing direct assistance, and managing the coordination of the Fund to meet the objectives of the Act.

The Fund is funded through federal capitalization grants as established under Section 1452 of the Act. The Act requires the State to provide matching funds equal to 20% of federal funds received. The grants were issued as follows:

<u>Grant Year</u>	<u>Total Available Funding</u>	<u>Federal Portion</u>	<u>State Portion</u>
1997	\$ 15,070,560	\$ 12,558,800	\$ 2,511,760
1999	17,502,120	14,585,100	2,917,020
2001	9,308,400	7,757,000	1,551,400
2002	9,346,920	7,789,100	1,557,820
2003	9,663,000	8,052,500	1,610,500
2004	9,604,920	8,004,100	1,600,820
2005	9,963,720	8,303,100	1,660,620
2006	9,942,600	8,285,500	1,657,100
2007	9,875,160	8,229,300	1,645,860
2008	19,650,000	16,375,000	3,275,000
2009	9,894,510	8,245,425	1,649,085
2010	16,287,600	13,573,000	2,714,600
2011	11,301,600	9,418,000	1,883,600
ARRA	<u>19,500,000</u>	<u>19,500,000</u>	-
Total	<u>\$176,911,110</u>	<u>\$150,675,925</u>	<u>\$26,235,185</u>

State of Delaware Drinking Water Revolving Loan Fund
Notes to Financial Statements (Continued)
Years Ended June 30, 2012 and 2011

Note A - Summary of Significant Accounting Policies (Continued)

1. General Background (Continued)

The federal grant years are one year behind the Fund's fiscal year. Therefore, federal year 2011 corresponds to the Fund's 2012 fiscal year.

For the 2008 grant's State match, the State used nonfederal administrative funds. The State match for 2009, 2010, and 2011 was paid from the 21st Century Fund.

The Fund received a grant of \$19,500,000 from the ARRA near the end of fiscal year 2009. The funds are available to be drawn for specific purposes. At June 30, 2012, 100% of ARRA funding was used for specific purposes. The ARRA funds do not have a State matching requirement.

The Fund is accounted for as an enterprise fund. The Fund is made up of several sub-funds, each of which is considered a separate accounting entity. The sub-funds are described below:

Loan Fund

The primary purpose of the Loan Fund is to serve as a permanent loan fund to make low-interest loans to public water systems.

Set-aside Sub-Funds

The Set-aside Sub-Funds are used to account for the proceeds of specific grant revenues that are legally restricted to expenditures for specific purposes.

There are four such funds:

- a. The 2% Technical Assistance Sub-Fund is used to account for the funds allotted to the State (up to 2% of the total) to provide assistance to public water systems serving 10,000 people or fewer.
- b. The 4% Administration Sub-Fund is used to account for the funds allotted to the State (up to 4% of the total) for the reasonable costs of administering the programs under Section 1452 and providing technical assistance. These costs may include such activities as issuing debt; program start-up costs; audit costs; financial, management and legal consulting fees; development of an intended use plan and priority ranking system; development of affordability criteria; and cost of support services provided by other State agencies.
- c. The 10% Program Management Sub-Fund is used to account for the funds allotted to the State (up to 10% of the total) to:
 - 1) Administer the State Public Water Supply System (PWSS) program;
 - 2) Administer or provide technical assistance through source water protection programs;

State of Delaware Drinking Water Revolving Loan Fund
Notes to Financial Statements (Continued)
Years Ended June 30, 2012 and 2011

Note A - Summary of Significant Accounting Policies (Continued)

1. General Background (Continued)

- 3) Develop and implement a capacity development strategy; and
- 4) Develop and implement an operator certification program.

The State must provide a dollar for dollar match (100% for up to 10% of the capitalization grant) for capitalization grant funds used for these purposes. This match is separate, and in addition to, the 20% match for the capitalization grant.

- d. The 15% Local Assistance Sub-Funds are used to fund several other categories of activities to assist development and implementation of local drinking water protection initiatives with the stipulation that not more than 20% of the capitalization grant amount can be used for any one activity.

2. Type of Entity and Division of Funds

The Fund is part of the reporting entity of the State. The Fund's activities are accounted for as a distinct operating unit within the DPH. Accordingly, the financial statements of the Fund are intended to present the financial position and the results of operations of only that portion of the funds and account groups of the State that is attributable to the transactions of the Fund.

3. Measurement Focus and Basis of Accounting

The Fund's activities are financed and operated as an enterprise fund. The accompanying financial statements of the Fund have been prepared on a cost of services or capital maintenance approach under the economic resources measurement focus. This means that all assets and all liabilities (whether current or noncurrent) associated with its activities are included on its statement of net assets. The operating statements present increases (revenues) and decreases (expenses) in total net assets. The Fund utilizes the accrual basis of accounting in conformity with U.S. generally accepted accounting principles applicable to governmental entities as prescribed by the Governmental Accounting Standard Board (GASB). Under this method, revenues are recorded when earned, and expenses are recorded when incurred, regardless of the timing of the related cash flows. 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.

Operating revenues and expenses consist of those revenues and expenses that result from the ongoing principal operations of the Fund. Operating revenues consist primarily of interest on loans receivable, and federal and state grants. Non-operating revenues and expenses consist of those revenues and expenses that are related to financing and investing types of activities and result from non-exchange transactions, such as investment income/loss.

The Fund has elected to apply all applicable GASB pronouncements as well as any applicable pronouncements of the Financial Accounting Standards Board (FASB), 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.

State of Delaware Drinking Water Revolving Loan Fund
Notes to Financial Statements (Continued)
Years Ended June 30, 2012 and 2011

Note A - Summary of Significant Accounting Policies (Continued)

4. Recognition of Revenues

By the terms of agreements between the State and the EPA, which commenced in fiscal year 1999, federal assistance provided to the Fund is earned when qualified loans and expenditures are made to eligible public water systems. Matching funds provided by the State are considered earned by the same criteria. However, in fiscal year 2002, the State's matching requirement for the Set-aside Sub-Funds was met using designated expenditures made for other programs; therefore, no State monies were required to be provided to the Set-aside Sub-Funds. The State's matching requirement for the Loan Fund was made using State General Fund monies.

Amounts earned in excess of grant monies received from the EPA and the State are recorded as grants receivable, whereas an excess of grant monies received over the amounts earned is recorded as unearned grant revenue. A right of set-off does not exist between the State and the EPA.

5. Cash and Cash Equivalents

Cash and cash equivalents consist of demand deposits, short-term money market securities, and other deposits held by financial institutions, generally with original maturities of three months or less (see Note B).

6. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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.

7. Reclassifications

Certain amounts in 2011 have been reclassified to conform with the 2012 presentation.

8. Adoption of Governmental Accounting Standards Board Statements

The Fund adopted the remaining provisions of GASB Statement No. 57, "*OPEB Measurements by Agent Employer and Agent Multiple-Employer Plans*". The adoption of this statement had no effect on previously reported amounts.

The Fund adopted the provisions of GASB Statement No. 64 "*Derivative Instruments: Application of Hedge Accounting Termination Provisions – an amendment of GASB Statement No. 53*". The adoption of this statement had no effect on the previously reported amounts.

9. Pending Changes in Accounting Principles

In November 2010, the GASB issued Statement No. 60, "*Accounting and Financial Reporting for Service Concession Arrangements*". The Fund is required to adopt statement No. 60 for its fiscal year 2013 financial statements.

State of Delaware Drinking Water Revolving Loan Fund
Notes to Financial Statements (Continued)
Years Ended June 30, 2012 and 2011

Note A - Summary of Significant Accounting Policies (Continued)

9. Pending Changes in Accounting Principles (Continued)

In November 2010, the GASB issued Statement No. 61 *“The Financial Reporting Entity: Omnibus—an amendment of GASB Statements No. 14 and No. 34”*. The Fund is required to adopt statement No. 61 for its fiscal year 2013 financial statements.

In December 2010, the GASB issued Statement No. 62 *“Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements”*. The Fund is required to adopt statement No. 62 for its fiscal year 2013 financial statements.

In June 2011, the GASB issued Statement No. 63 *“Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position”*. The Fund is required to adopt statement No. 63 for its fiscal year 2013 financial statements.

In March 2012, the GASB issued Statement No. 65, *“Items Previously Reported as Assets and Liabilities”*. The Fund is required to adopt statement No. 65 for its fiscal year 2014 financial statements.

In March 2012, the GASB issued Statement No. 66, *“Technical Corrections – 2012 – An Amendment of GASB Statements No. 10 and No. 62”*. The Fund is required to adopt statement No. 66 for its fiscal year 2014 financial statements.

In June 2012, the GASB issued Statement No. 67, *“Financial Reporting for Pension Plans – an amendment of GASB Statement No. 25”*. The Fund is required to adopt statement No. 67 for its fiscal year 2014 financial statements.

In June 2012, the GASB issued Statement No. 68, *“Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27”*. The Fund is required to adopt statement No. 68 for its fiscal year 2015 financial statements.

In January 2013, the GASB issued Statement No. 69, *“Government Combinations and Disposals of Government Operations”*. The Fund is required to adopt statement No. 69 for its fiscal year 2015 financial statements.

The Fund has not completed the various analyses required to estimate the financial statement impact of these new pronouncements.

Note B - Cash and Cash Equivalents

Cash - State Treasurer’s Pool

Cash, as reported on the statements 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 (the 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

State of Delaware Drinking Water Revolving Loan Fund
Notes to Financial Statements (Continued)
Years Ended June 30, 2012 and 2011

Note B - Cash and Cash Equivalents (Continued)

Cash - State Treasurer's Pool (Continued)

categorized as to risk because they are not evidenced by securities that exist in 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.

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.

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

State of Delaware Drinking Water Revolving Loan Fund
Notes to Financial Statements (Continued)
Years Ended June 30, 2012 and 2011

Note C - Available Funding, Disbursements, and Remaining Balance by Funding Year

As of June 30, 2012, the Fund had federal grants totaling \$150,675,925, from which it had made disbursements of \$114,593,999. The breakdown for all grants is as follows:

Loan Fund

<u>Grant Year</u>	Committed Portion of Available <u>Funding</u>	Disbursed to Date	Remaining <u>Balance</u>
1997	\$ 9,288,036	\$ 9,288,036	\$ -
1999	11,642,600	11,642,600	-
2001	5,852,330	5,852,330	-
2002	5,653,979	5,653,979	-
2003	6,190,765	6,190,765	-
2004	6,164,343	6,164,343	-
2005	6,281,257	6,281,257	-
2006	6,229,432	6,229,432	-
2007	5,957,099	5,957,099	-
2008	15,562,690	6,287,633	9,275,057
2009	5,735,685	-	5,735,685
2010	11,108,400	-	11,108,400
2011	6,877,518	61,146	6,816,372
ARRA	<u>18,778,138</u>	<u>18,778,138</u>	<u>-</u>
Total	<u>\$121,322,272</u>	<u>\$88,386,758</u>	<u>\$32,935,514</u>

Set-aside Sub-Funds

2% Technical Assistance

<u>Grant Year</u>	Committed Portion of Available <u>Funding</u>	Disbursed to Date	Remaining <u>Balance</u>
1997	\$ 251,176	\$ 251,176	\$ -
1999	291,702	291,702	-
2001	155,140	155,140	-
2002	155,782	155,782	-
2003	75,133	75,133	-
2004	86,937	86,937	-
2005	166,062	166,062	-
2006	149,588	149,588	-
2007	164,586	164,586	-
2008	-	-	-
2009	147,400	147,111	289
2010	154,700	43,247	111,453
2011	160,000	19,941	140,059
ARRA	<u>-</u>	<u>-</u>	<u>-</u>
Total	<u>\$1,958,206</u>	<u>\$1,706,405</u>	<u>\$251,801</u>

State of Delaware Drinking Water Revolving Loan Fund
Notes to Financial Statements (Continued)
Years Ended June 30, 2012 and 2011

Note C - Available Funding, Disbursements, and Remaining Balance by Funding Year
(Continued)

4% Administration

<u>Grant Year</u>	<u>Committed Portion of Available Funding</u>	<u>Disbursed to Date</u>	<u>Remaining Balance</u>
1997	\$ 502,352	\$ 502,352	\$ -
1999	583,404	583,404	-
2001	310,280	310,280	-
2002	311,564	311,564	-
2003	305,960	305,960	-
2004	215,566	215,566	-
2005	332,124	332,124	-
2006	329,284	329,284	-
2007	329,172	329,172	-
2008	-	-	-
2009	325,840	315,264	10,576
2010	480,780	272,235	208,545
2011	368,609	182,304	186,305
ARRA	<u>721,862</u>	<u>721,862</u>	<u>-</u>
Total	<u>\$5,116,797</u>	<u>\$4,711,371</u>	<u>\$405,426</u>

10% Program Management

<u>Grant Year</u>	<u>Committed Portion of Available Funding</u>	<u>Disbursed to Date</u>	<u>Remaining Balance</u>
1997	\$ 633,416	\$ 633,416	\$ -
1999	1,458,510	1,458,510	-
2001	775,700	775,700	-
2002	778,910	778,910	-
2003	805,250	805,250	-
2004	736,904	736,904	-
2005	830,310	830,310	-
2006	811,893	811,893	-
2007	822,930	822,930	-
2008	500,000	449,751	50,249
2009	814,600	739,182	75,418
2010	928,512	504,569	423,943
2011	864,313	237,136	627,177
ARRA	<u>-</u>	<u>-</u>	<u>-</u>
Total	<u>\$10,761,248</u>	<u>\$9,584,461</u>	<u>\$1,176,787</u>

State of Delaware Drinking Water Revolving Loan Fund
Notes to Financial Statements (Continued)
Years Ended June 30, 2012 and 2011

Note C - Available Funding, Disbursements, and Remaining Balance by Funding Year (Continued)

15% Local Assistance

<u>Grant Year</u>	Committed Portion of Available <u>Funding</u>	Disbursed to Date	Remaining <u>Balance</u>
1997	\$ 1,883,820	\$1,883,820	\$ -
1999	608,884	608,884	-
2001	663,550	663,550	-
2002	888,865	888,865	-
2003	675,392	675,392	-
2004	800,350	800,350	-
2005	693,347	693,347	-
2006	765,303	765,303	-
2007	955,513	955,513	-
2008	312,310	299,306	13,004
2009	1,221,900	1,066,432	155,468
2010	900,608	590,711	309,897
2011	1,147,560	313,531	834,029
ARRA	-	-	-
Total	<u>\$11,517,402</u>	<u>\$10,205,004</u>	<u>\$1,312,398</u>

Total Program Balance

<u>Grant Year</u>	Committed Portion of Available <u>Funding</u>	Disbursed to Date	Remaining <u>Balance</u>
1997	\$ 12,558,800	\$ 12,558,800	\$ -
1999	14,585,100	14,585,100	-
2001	7,757,000	7,757,000	-
2002	7,789,100	7,789,100	-
2003	8,052,500	8,052,500	-
2004	8,004,100	8,004,100	-
2005	8,303,100	8,303,100	-
2006	8,285,500	8,285,500	-
2007	8,229,300	8,229,300	-
2008	16,375,000	7,036,690	9,338,310
2009	8,245,425	2,267,989	5,977,436
2010	13,573,000	1,410,762	12,162,238
2011	9,418,000	814,058	8,603,942
ARRA	<u>19,500,000</u>	<u>19,500,000</u>	-
Total	<u>\$150,675,925</u>	<u>\$114,593,999</u>	<u>\$36,081,926</u>

Note D - Federal Grants Receivable

Grants receivable of \$171,214 and \$1,810,004, as of June 30, 2012 and 2011, respectively, represent amounts due from the federal government for amounts expended or accrued.

State of Delaware Drinking Water Revolving Loan Fund
Notes to Financial Statements (Continued)
Years Ended June 30, 2012 and 2011

Note E - Loans Receivable

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

	<u>Binding</u> <u>Commitments</u>	<u>Loans Receivable</u>	
		<u>2012</u>	<u>2011</u>
Municipal			
Town of Felton	\$ 370,000	\$ 144,379	\$ 192,922
Town of Frankford	1,095,000	740,478	831,027
Town of Blades	515,300	355,629	380,386
Town of Milton	643,370	448,759	498,820
City of Wilmington	69,555,000	49,717,192	43,657,765
Town of Greenwood	1,460,230	1,418,839	1,441,009
Town of Dagsboro	1,400,000	1,095,923	1,169,507
Town of Millsboro	5,139,700	4,625,627	4,714,407
Town of Laurel	4,155,200	3,786,349	3,124,101
Town of Smyrna	7,279,000	6,286,577	5,709,892
City of Lewes	2,016,000	998,834	1,053,149
Town of Clayton	850,000	732,361	767,115
Town of Bridgeville	250,000	153,182	206,830
City of Rehoboth Beach	5,000,000	4,351,160	4,682,248
City of Seaford	2,729,408	2,766,288	2,428,562
City of Dover	2,404,017	2,354,745	480,528
Town of Delmar	400,206	149,964	26,235
Town of Middletown	3,011,000	490,686	-
City of Milford	4,045,000	98,071	-
Town of Selbyville	1,400,000	161,319	-
Town of Georgetown	<u>4,351,500</u>	<u>409,673</u>	<u>85,125</u>
Total Municipal	118,069,931	81,286,035	71,449,628
Investor-Owned			
Artesian Water Company	20,187,644	8,888,128	8,441,465
Tidewater Utilities, Inc.	14,524,493	10,413,123	8,896,920
J.H. Wilkerson & Son, Inc.	<u>410,800</u>	<u>232,531</u>	<u>258,576</u>
Total Investor-Owned	35,122,937	19,533,782	17,596,961
Mobile Home Park			
Innovative Construction	<u>\$ 34,321</u>	<u>\$ 18,580</u>	<u>\$ 20,274</u>
	<u>\$153,227,189</u>	100,838,397	89,066,863
Less: ARRA reserve		<u>9,752,630</u>	<u>8,569,252</u>
Loans Receivable		91,085,767	80,497,611
Less: loans receivable - current portion		<u>4,379,384</u>	<u>4,225,250</u>
Loans Receivable - Net of Current Portion		<u>\$ 86,706,383</u>	<u>\$76,272,361</u>

State of Delaware Drinking Water Revolving Loan Fund
Notes to Financial Statements (Continued)
Years Ended June 30, 2012 and 2011

Note E - Loans Receivable (Continued)

Interest charged on these loans ranges from 0.00% to 4.48%. Interest earned on loans receivable was \$2,508,972 and \$1,313,622 for the years ended June 30, 2012 and 2011, respectively.

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 investor-owned and mobile home park loans.

There was no allowance for doubtful accounts as of June 30, 2012 and 2011. As of June 30, 2012 and 2011, there were no material delinquent loan balances. There were no loan defaults for the years ended June 30, 2012 and 2011. There has been no history of significant bad debts or uncollectible accounts.

The ARRA reserve of \$9,752,630 and \$8,569,252 represents expenditures for loans that were reclassified as grants to the municipalities at the time of disbursement. As of June 30, 2012 and 2011 respectively, the respective construction periods for these loans are completed.

Note F - Unearned Revenue - State Match

As of June 30, 2012, the Fund had total available State match funding in its separate cash account as follows:

<u>Grant Year</u>	<u>Committed Portion of Available Funding</u>	<u>Disbursed to Date</u>	<u>Remaining Balance</u>
1997	\$ 2,511,760	\$ 2,511,760	\$ -
1999	2,917,000	2,917,000	-
2001	1,551,400	1,551,400	-
2002	1,557,820	1,557,820	-
2003	1,610,500	1,610,500	-
2004	1,600,820	1,600,820	-
2005	1,660,620	1,660,620	-
2006	1,657,100	1,657,100	-
2007	1,645,860	1,645,860	-
2008	-	-	-
2009	1,649,085	-	1,649,085
2010	2,714,600	-	2,714,600
2011	<u>1,883,600</u>	<u>-</u>	<u>1,883,600</u>
Total	<u>\$22,960,165</u>	<u>\$16,712,880</u>	<u>\$6,247,285</u>

Interest earned on cash deposits totaled \$134,031 and \$197,495 for the years ended June 30, 2012 and 2011, respectively.

For the grant year 2008, the Fund's state match was \$3,275,000 of which \$1,592,937 was disbursed from nonfederal administrative funds as of June 30, 2012. The remaining balance of state match required for the 2008 grant year is \$1,682,063.

State of Delaware Drinking Water Revolving Loan Fund
Notes to Financial Statements (Continued)
Years Ended June 30, 2012 and 2011

Note G - Pension

Employees of the Fund are considered employees of the State and are covered under the State Employees' Pension Plan. Total pension cost of \$96,868 for 2012 and \$76,916 for 2011 is included in salaries and related benefits.

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.

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.

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.

State of Delaware Drinking Water Revolving Loan Fund
Notes to Financial Statements (Continued)
Years Ended June 30, 2012 and 2011

Note G - Pension (Continued)

Contributions

Employer - Determined by Board of Pension Trustees.

Employee - 3% of earnings in excess of \$6,000.

Post-2011 employees - 5% 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.

Note H - Commitments and Contingencies

1. Loans

The Fund has met its prior binding commitments (equal to at least 120% of each quarterly payment within one (1) year of receipt of that payment). As of June 30, 2012, there were cumulative binding commitments of \$153,227,189.

2. 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 that 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.

Note I - 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 healthcare 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.

State of Delaware Drinking Water Revolving Loan Fund
Notes to Financial Statements (Continued)
Years Ended June 30, 2012 and 2011

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 Fund requested that \$27,050,177 in grant award funds be deobligated from the Fund and transferred to the Department of Natural Resources and Environmental Control (DNREC), Delaware Water Pollution Control Revolving Loan Fund (DWPCRLF). On July 25, 2012, the EPA deobligated this amount from the Fund's grant award and awarded the funds to the DWPCRLF.

In addition, on July 25, 2012, the Fund transferred \$5,410,035 in State match funds directly to the DWPCRLF. In fiscal year 2013, the Fund and the DWPCRLF will be consolidated into one fund for administration of loans and federal grant awards. The transfer of State match funds is to be used by DWPCRLF towards meeting the match on upcoming grant funds received from the EPA.

Supplemental Information

State Of Delaware Drinking Water Revolving Loan Fund
Schedule Of Fund Net Assets By Fund
For The Year Ended June 30, 2012

	<u>Loan Fund</u>	<u>2% Technical Assistance</u>	<u>4% Administration</u>	<u>10% Program Management</u>	<u>15% Local Assistance</u>	<u>Total</u>
Current Assets						
Cash and cash equivalents	\$ 25,247,577	\$ -	\$ -	\$ -	\$ -	\$ 25,247,577
Loans receivable	4,379,384	-	-	-	-	4,379,384
Interest receivable	710,484	-	-	-	-	710,484
Federal grants receivable	110,703	-	12,919	15,806	31,786	171,214
Total Current Assets	30,448,148	-	12,919	15,806	31,786	30,508,659
Noncurrent Assets						
Loans receivable	86,706,383	-	-	-	-	86,706,383
Total Assets	117,154,531	-	12,919	15,806	31,786	117,215,042
Current Liabilities						
Vouchers payable	54,003	-	12,919	15,806	31,786	114,514
Total Current Liabilities	54,003	-	12,919	15,806	31,786	114,514
Long-Term Liabilities						
Unearned revenue - state match	6,247,285	-	-	-	-	6,247,285
Total Liabilities	6,301,288	-	12,919	15,806	31,786	6,361,799
Net Assets						
Net assets - unrestricted	110,853,243	-	-	-	-	110,853,243
Total Liabilities and Net Assets	\$ 117,154,531	\$ -	\$ 12,919	\$ 15,806	\$ 31,786	\$ 117,215,042

State of Delaware Drinking Water Revolving Loan Fund
Schedule of Fund Net Assets By Fund
For the Year Ended June 30, 2011

	<u>Loan Fund</u>	<u>2% Technical Assistance</u>	<u>4% Administration</u>	<u>10% Program Management</u>	<u>15% Local Assistance</u>	<u>Total</u>
Current Assets						
Cash and cash equivalents	\$ 20,840,154	\$ -	\$ -	\$ -	\$ -	\$ 20,840,154
Loans receivable	4,225,250	-	-	-	-	4,225,250
Interest receivable	1,006,607	-	-	-	-	1,006,607
Federal grants receivable	1,810,004	-	-	-	-	1,810,004
State grants receivable	<u>3,275,000</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>3,275,000</u>
Total Current Assets	31,157,015	-	-	-	-	31,157,015
Noncurrent Assets						
Loans receivable	<u>76,272,361</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>76,272,361</u>
Total Assets	<u>107,429,376</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>107,429,376</u>
Current Liabilities						
Payable to DNREC	<u>2,028,286</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>2,028,286</u>
Total Current Liabilities	2,028,286	-	-	-	-	2,028,286
Long-Term Liabilities						
Unearned revenue - state match	<u>8,732,267</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>8,732,267</u>
Total Liabilities	10,760,553	-	-	-	-	10,760,553
Net Assets						
Net assets - unrestricted	<u>96,668,823</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>96,668,823</u>
Total Liabilities and Net Assets	<u>\$ 107,429,376</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 107,429,376</u>

State of Delaware Drinking Water Revolving Loan Fund
Schedule of Revenues, Expenses, and Changes in Fund Net Assets By Fund
For the Year Ended June 30, 2012

	Loan Fund	2% Technical Assistance	4% Administration	10% Program Management	15% Local Assistance	Total
Operating Revenue						
Interest income - loans	\$ 1,254,486	\$ -	\$ -	\$ -	\$ -	\$ 1,254,486
Interest income - administrative fees	1,254,486	-	-	-	-	1,254,486
Loan origination fees	89,317	-	-	-	-	89,317
Grant revenue	11,930,587	169,919	542,163	803,780	943,940	14,390,389
ARRA loan forgiveness	(1,183,378)	-	-	-	-	(1,183,378)
Write off of receivables	(16,000)	-	-	-	-	(16,000)
State match	720,891	-	-	-	-	720,891
Total Operating Revenue	14,050,389	169,919	542,163	803,780	943,940	16,510,191
Operating Expenses						
Salaries and related benefits	-	-	325,396	359,521	243,028	927,945
Contract services	-	156,710	98,417	134,194	144,862	534,183
Indirect costs	-	-	18,641	13,561	13,342	45,544
Subgrants	-	-	90,959	268,334	468,661	827,954
Supplies	-	2,584	7,390	15,569	29,489	55,032
Equipment	-	-	-	1,626	2,218	3,844
Training	-	10,625	-	-	39,211	49,836
Travel	-	-	1,360	10,975	3,129	15,464
Total Operating Expenses	-	169,919	542,163	803,780	943,940	2,459,802
Operating Income	14,050,389	-	-	-	-	14,050,389
Nonoperating Revenues and Expenses						
Interest income - cash accounts	134,031	-	-	-	-	134,031
Total Nonoperating Revenues and Expenses	134,031	-	-	-	-	134,031
Increase in Net Assets	14,184,420	-	-	-	-	14,184,420
Net Assets - Beginning of Year	96,668,823	-	-	-	-	96,668,823
Net Assets - End of Year	\$ 110,853,243	\$ -	\$ -	\$ -	\$ -	\$ 110,853,243

State of Delaware Drinking Water Revolving Loan Fund
Schedule of Revenues, Expenses, and Changes in Fund Net Assets By Fund
For the Year Ended June 30, 2011

	Loan Fund	2% Technical Assistance	4% Administration	10% Program Management	15% Local Assistance	Total
Operating Revenues						
Interest income - loans	\$ 656,811	\$ -	\$ -	\$ -	\$ -	\$ 656,811
Interest income - administrative fees	656,811	-	-	-	-	656,811
Loan origination fees	50,000	-	-	-	-	50,000
Grant revenue	13,312,227	137,878	565,409	1,098,156	510,458	15,624,128
ARRA loan forgiveness	(3,239,959)	-	-	-	-	(3,239,959)
Write off of receivables	-	-	-	-	-	-
State match	1,695,957	-	-	-	-	1,695,957
Total Operating Revenue	13,131,847	137,878	565,409	1,098,156	510,458	15,443,748
Operating Expenses						
Salaries and related benefits	-	2,294	350,929	184,019	167,024	704,266
Contract services	-	135,342	149,972	285,185	209,329	779,828
Indirect costs	-	242	30,950	11,828	8,772	51,792
Subgrants	-	-	28,895	591,046	102,804	722,745
Supplies	-	-	10	20,373	20,090	40,473
Equipment	-	-	-	-	-	-
Training	-	-	2,200	-	-	2,200
Travel	-	-	2,453	5,705	2,439	10,597
Total Operating Expenses	-	137,878	565,409	1,098,156	510,458	2,311,901
Operating Income	13,131,847	-	-	-	-	13,131,847
Nonoperating Revenues and Expenses						
Interest income - cash accounts	197,495	-	-	-	-	197,495
Total Nonoperating Revenues and Expenses	197,495	-	-	-	-	197,495
Increase in Net Assets	13,329,342	-	-	-	-	13,329,342
Net Assets - Beginning of Year	83,339,481	-	-	-	-	83,339,481
Net Assets - End of Year	\$ 96,668,823	\$ -	\$ -	\$ -	\$ -	\$ 96,668,823

State of Delaware Drinking Water Revolving Loan Fund
Schedules Of Fund Net Assets By Classification
June 30, 2012 AND 2011

	2012				2011			
	Federal Administrative Fund	Capital Reserve Fund	Nonfederal Administrative Fund	Total	Federal Administrative Fund	Capital Reserve Fund	Nonfederal Administrative Fund	Total
Current Assets								
Cash and cash equivalents	\$ -	\$ 19,041,623	\$ 6,205,954	\$ 25,247,577	\$ -	\$ 14,735,116	\$ 6,105,038	\$ 20,840,154
Loans receivable - current portion	-	4,379,384	-	4,379,384	-	4,225,250	-	4,225,250
Interest receivable	-	355,242	355,242	710,484	-	503,304	503,303	1,006,607
Federal grants receivable	60,511	110,703	-	171,214	-	1,810,004	-	1,810,004
State grants receivable	-	-	-	-	-	3,275,000	-	3,275,000
Total Current Assets	60,511	23,886,952	6,561,196	30,508,659	-	24,548,674	6,608,341	31,157,015
Noncurrent Assets								
Loans receivable - net of current portion	-	86,706,383	-	86,706,383	-	76,272,361	-	76,272,361
Total Assets	60,511	110,593,335	6,561,196	117,215,042	-	100,821,035	6,608,341	107,429,376
Current Liabilities								
Vouchers payable	60,511	54,003	-	114,514	-	2,028,286	-	2,028,286
Total Current Liabilities	60,511	54,003	-	114,514	-	2,028,286	-	2,028,286
Long-Term Liabilities								
Unearned revenue - state match	-	6,247,285	-	6,247,285	-	8,732,267	-	8,732,267
Total Liabilities	60,511	6,301,288	-	6,361,799	-	10,760,553	-	10,760,553
Net Assets								
Net assets - unrestricted	-	104,292,047	6,561,196	110,853,243	-	90,060,482	6,608,341	96,668,823
Total Liabilities and Net Assets	\$ 60,511	\$ 110,593,335	\$ 6,561,196	\$ 117,215,042	\$ -	\$ 100,821,035	\$ 6,608,341	\$ 107,429,376

State of Delaware Drinking Water Revolving Loan Fund
Schedules of Revenues, Expenses, and Changes in Fund Net Assets By Classification
June 30, 2012 and 2011

	2012				2011			
	Federal Administrative Fund	Capital Reserve Fund	Nonfederal Administrative Fund	Total	Federal Administrative Fund	Capital Reserve Fund	Nonfederal Administrative Fund	Total
Operating Revenue								
Interest income - loans	\$ -	\$ 1,254,486	\$ -	\$ 1,254,486	\$ -	\$ 656,811	\$ -	\$ 656,811
Interest income - administrative fees	-	-	1,254,486	1,254,486	-	-	656,811	656,811
Loan origination fees	-	-	89,317	89,317	-	-	50,000	50,000
Grant revenue	2,459,802	11,930,587	-	14,390,389	2,311,901	13,312,227	-	15,624,128
ARRA loan forgiveness	-	(1,183,378)	-	(1,183,378)	-	(3,239,959)	-	(3,239,959)
Write off of receivables	-	-	(16,000)	(16,000)	-	-	-	-
State match	-	2,133,116	(1,412,225)	720,891	-	1,695,957	-	1,695,957
Total Operating Revenue	2,459,802	14,134,811	(84,422)	16,510,191	2,311,901	12,425,036	706,811	15,443,748
Operating Expenses								
Salaries and related benefits	927,945	-	-	927,945	704,266	-	-	704,266
Contract services	534,183	-	-	534,183	779,828	-	-	779,828
Indirect costs	45,544	-	-	45,544	51,792	-	-	51,792
Subgrants	827,954	-	-	827,954	722,745	-	-	722,745
Supplies	55,032	-	-	55,032	40,473	-	-	40,473
Equipment	3,844	-	-	3,844	-	-	-	-
Training	49,836	-	-	49,836	2,200	-	-	2,200
Travel	15,464	-	-	15,464	10,597	-	-	10,597
Total Operating Expenses	2,459,802	-	-	2,459,802	2,311,901	-	-	2,311,901
Operating Income (Loss)	-	14,134,811	(84,422)	14,050,389	-	12,425,036	706,811	13,131,847
Nonoperating Revenues and Expenses								
Interest income - cash accounts	-	96,754	37,277	134,031	-	159,568	37,927	197,495
Total Nonoperating Revenues and Expenses	-	96,754	37,277	134,031	-	159,568	37,927	197,495
Change in Net Assets	-	14,231,565	(47,145)	14,184,420	-	12,584,604	744,738	13,329,342
Net Assets - Beginning of Year As Restated	-	90,060,482	6,608,341	96,668,823	-	77,475,878	5,863,603	83,339,481
Net Assets - End of Year	\$ -	\$ 104,292,047	\$ 6,561,196	\$ 110,853,243	\$ -	\$ 90,060,482	\$ 6,608,341	\$ 96,668,823

Zelenkofske Axelrod LLC

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 Office of Auditor of Accounts
Dover, Delaware

We were engaged to audit the financial statements of the business-type activities, of the State of Delaware Drinking Water Revolving Loan Fund, as of and for the year ended June 30, 2012, which collectively comprise the State of Delaware Drinking Water Revolving Loan Fund's basic financial statements and have issued our report thereon dated April 8, 2013. We did not express an opinion on these financial statements because we were unable to confirm beginning or ending cash balances, 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 State of Delaware Drinking Water Revolving Loan Fund, is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the State of Delaware Drinking Water Revolving Loan 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 State of Delaware Drinking Water Revolving Loan Fund's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the State of Delaware Drinking Water Revolving Loan 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 certain deficiencies in internal control over financial reporting that we consider to be material weaknesses.

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 deficiencies described as finding 12-1 and 12-2 in the accompanying schedule of findings and responses to be material weaknesses.

Harrisburg	Lehigh Valley	Philadelphia	Pittsburgh
830 Sir Thomas Court, Suite 100 Harrisburg, PA 17109 717.561.9200 Fax 717.561.9202	1101 West Hamilton Street Allentown, PA 18101-1043 610.871.5077 Fax 717.561.9202	2370 York Road, Suite A-5 Jamison, PA 18929 215.918.2277 Fax 215.918.2302	800 McKnight E. Drive, Suite 3805 Pittsburgh, PA 15237 412.367.7102 Fax 412.367.7103

Zelenkofske Axelrod LLC

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State of Delaware Drinking Water Revolving Loan 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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as findings 12-1 and 12-2.

The State of Delaware Drinking Water Revolving Loan 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 State of Delaware Drinking Water Revolving Loan Fund's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, others within the entity, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.



Zelenkofske Axelrod LLC

Harrisburg, PA
April 8, 2013

State of Delaware Drinking Water Revolving Loan Fund
 Schedule of Findings and Responses
 For the Year Ended June 30, 2012

Current Year Findings

Finding 12-1

Accounting Records

Criteria: The Environmental Protection Agency, from which the State of Delaware Drinking Water Revolving Loan Fund (“Fund”) receives the majority of its grant funding requires the fund to maintain an accurate up-to-date accrual basis general ledger to account for the activity of the Fund.

Condition: The Fund does not maintain a general ledger that accounts for all the activity of the fund. There is no consolidation of the accounting records of the Fund, and therefore it is not possible to obtain financial statements that would include a statement of net assets and a statement of revenues and expenses and changes in net assets. The Fund only maintains the revenue and expense activity during the year in its accounting software. Loan activity is maintained on separate excel spreadsheets throughout the year, and no balance sheet accounts are maintained.

The Fund contracted a third-party CPA firm to compile the June 30, 2012 financial statements. During the course of this compilation, the third-party CPA firm posted a large number of adjustments to reconcile the general ledger accounts to supporting subsidiary schedules maintained on separate excel spreadsheets.

Cause: Balance sheet activity of the Fund was not recorded during the year in the Fund’s general ledger.

Effect: The Fund did not reflect the correct financial activity of the Fund throughout the year on its accounting software, resulting in a large number of year end adjustments made by the third-party CPA firm.

Recommendation: The Fund should maintain its accounting system on the accrual basis during the year reflecting all activity of the Fund during the year that would include a statement of net assets, and a statement of revenues and expenses and changes in net assets.

Management’s Response:

The Drinking Water State Revolving Fund will consolidate all accounting records and maintain the accounting system on the accrual basis. Additionally, the Fund will reflect all activity in its accounting software and develop the required financial statements.

The Clean Water and Drinking Water funds are currently evaluating vendors for a project and loan servicing software application. The application will replace the subsidiary schedules maintained on spreadsheets.

State of Delaware Drinking Water Revolving Loan Fund
Schedule of Findings and Responses (Continued)
For the Year Ended June 30, 2012

Current Year Findings (Continued)

Finding 12-2

Cash Reconciliations

Criteria:	The Environmental Protection Agency, from which the fund receives the majority of its grants, requires that a separate account, or series of accounts, that is dedicated solely to providing loans and other forms of financial assistance from the Drinking Water State Revolving Fund (DWSRF). All loan repayments (including principal and interest) and interest earnings on investments must be credited directly to the DWSRF.
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. As a result, we were unable to verify compliance with the afore mentioned criteria.
Cause:	The State is not able to provide a report that distinguishes cash balances by agency or department.
Effect:	Compliance with grant requirements was not able to be verified, and cash balances 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:	The Drinking Water State Revolving Fund will investigate options to reconcile cash balances that correspond to the First State Financial accounting system.

State of Delaware Drinking Water Revolving Loan Fund
Summary Schedule of Prior Audit Findings
For the Year Ended 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	Audit Adjustments	See Finding 12-1
11-02	Loan Reconciliation	See Finding 12-2