

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

Financial Statements – Modified Cash Basis

For the Year Ended June 30, 2016

Report Issued: January 3, 2017

State of Delaware
Department of Natural Resources and Environmental Control
Hazardous Substance Cleanup Fund
Table of Contents
For the Year Ended June 30, 2016

	<u>Pages</u>
Independent Auditors' Report	1-2
Financial Statements:	
Balance Sheet - Modified Cash Basis	3
Statement of Revenues, Expenditure, and Change in Fund Balance - Modified Cash Basis	4
Notes to Financial Statements - Modified Cash Basis	5 - 10
Supplemental Information:	
Schedule of Revenues, Expenditure, and Change in Fund Balance by Account - Modified Cash Basis	12
Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	13-14
Schedule of Findings and Responses	15

Zelenkofske Axelrod LLC

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying modified cash basis financial statements of the Department of Natural Resources and Environmental Control Hazardous Substance Cleanup Fund of the State of Delaware (the "Fund"), as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the Fund's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the modified cash basis of accounting described in Note B to the financial statements; this includes determining that the modified cash basis of accounting is an acceptable basis for the preparation of the financial statements in the circumstances. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Fund's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the modified cash basis financial position of the Fund as of June 30, 2016, and the modified cash basis financial position for the year then ended in accordance with the modified cash basis of accounting described in Note B.

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Zelenkofske Axelrod LLC

Basis of Accounting

We draw attention to Note B of the financial statements, which describes the basis of accounting. The financial statements are prepared on the modified cash basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Emphasis of Matter

As discussed in Note A, the financial statements present only the Department of Natural Resources and Environmental Control Hazardous Substance Cleanup Fund and do not purport to, and do not present fairly the financial position of the State of Delaware, as of June 30, 2016, the changes in its financial position, or its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matters

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Fund's basic financial statements. The schedule of revenues, expenditure, and change in fund balance by account – modified cash basis is presented for purposes of additional analysis is not a required part of the basic financial statements.

The schedule of revenues, expenditure, and change in fund balance by account – modified cash basis is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. This information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of revenues, expenditure, and change in fund balance by account – modified cash basis is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated December 13, 2016, on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Fund's internal control over financial reporting and compliance.

Zelenkofske Axelrod LLC

ZELENKOFSCHE AXELROD LLC

Harrisburg, Pennsylvania
December 13, 2016

State of Delaware
Department of Natural Resources and Environmental Control
Hazardous Substance Cleanup Fund
Balance Sheet - Modified Cash Basis
June 30, 2016

Assets:

Pooled cash \$ 24,229,303

Total Assets \$ 24,229,303

Fund Balance:

Restricted by enabling legislation \$ 24,229,303

Department of Natural Resources and Environmental Control

Hazardous Substance Cleanup Fund

Statement of Revenues, Expenditure, and Change in Fund Balance - Modified Cash Basis

For the Year Ended June 30, 2016

Revenues:	
Tax assessments	\$ 7,345,782
Cost recovery	412,108
Voluntary cleanup	248,470
Interest	172,342
Other	<u>169,890</u>
Total Revenues	8,348,592
Expenditure:	
Cleanup program	<u>17,261,607</u>
Total Expenditure	<u>17,261,607</u>
Net Change in Fund Balance	(8,913,015)
Fund Balance - Beginning of Year	<u>33,142,318</u>
Fund Balance - End of Year	<u><u>\$ 24,229,303</u></u>

Note A - Summary of Operations

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

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

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

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

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

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

Note B - Summary of Significant Accounting Policies

Basis of Accounting

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

Note B - Summary of Significant Accounting Policies –Continued

The statement of revenues, expenditure, and change in fund balance present sources and uses of available spendable financial resources during a given period and use fund balance as the measure of available spendable financial resources at the end of the period.

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

Fund Balance

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

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

All fund balance is restricted per enabling legislation.

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

Note C - Pooled Cash

Pooled Cash - State Treasurer’s Pool

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

Note C - Pooled Cash – Continued

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

The Cash Management Policy Board

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

Investment Guidelines and Management

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

Collateralization Requirements

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

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

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

Note C - Pooled Cash - Continued

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

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

Note D - Revenues

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

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

Note E - Commitments

DNREC has identified over 1,129 sites in Delaware as potential hazardous substance release sites, some of which have been assigned a higher priority (identified as posing a risk to public health, welfare, and/or the environment). These sites are being addressed either under HSCA or under the Federal Superfund Program (National Priority List), with work complete at many of the sites. Additionally, since the inception of Delaware's Voluntary Cleanup Program (begun in 1993) and the Brownfields Program (begun in 1995), 447 sites have entered the program; 175 sites are currently undergoing cleanup; and 272 sites have been cleaned up for reuse. The cost of cleaning up the remaining sites exceeds the money available to the Fund.

Note F - Leases

On August 23, 2010, the Fund signed an amendment to an original lease dated January 23, 1998, for a cancelable seven-year operating lease agreement for office space located at 391 Lukens Drive, Riveredge Industrial Park, New Castle, Delaware. The amendment to the original lease commenced on November 1, 2010, and is cancelable only upon loss of funding. The total lease expense for the Fund for the year ended June 30, 2016 was \$191,993.

Future minimum lease payments under cancelable operating leases as of June 30, 2016, for the Fund are as follows for the years ending June 30:

2017	381,428
2018	<u>128,389</u>
Total	<u><u>\$ 509,817</u></u>

Note G - Change in Legislation

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

Note H - Employee Benefits

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

The Fund contributes monthly to the State Employees' Pension Plan (the Pension Plan), as required by State statutes. Total pension payments of \$379,577 on total wages of \$1,824,892 are included in the financial statements, which is equal to the required contribution. The Pension Plan is a cost-sharing multiple employer defined benefit plan that covers virtually all full-time or regular part-time employees of the State. The State of Delaware General Assembly is responsible for setting benefits and contributions and amending plan provisions.

Certain significant Pension Plan provisions follow:

1. Retirement - Individuals hired prior to January 1, 2012, age 62 with 5 years of credited service; age 60 with 15 years of credited service; or after 30 years of credited service at any age. Individuals hired on or after January 1, 2012, age 65 with 10 years of credited service; age 60 with 20 years of credited service; or after 30 years of credited service at any age.
2. Service Benefits – Final average monthly compensation multiplied by 2.0% and multiplied by years of credited service prior to January 1, 1997, plus final average compensation multiplied by 1.85% and multiplied by years of credited service after December 31, 1996, subject to minimum limitations. For this plan, final average monthly compensation is the monthly average of the highest three years of compensation.
3. Disability Benefits – Pre-2012 date of hire: Same as Service Benefits. Employee must have five years of credited service. In lieu of disability pension benefits, over 90% of the members of this plan opted into a disability insurance program.
4. Vested pension - Pre-2012 date of hire: Five years of credited service. Post-2011 date of hire: 10 years of credited service.
5. Survivor Benefits-If employee is receiving a pension, the eligible survivor receives 50% of the pension (or 67.7% with a 2% reduction of benefits, 75% with 3% reduction of benefits, or 100% with a 6% reduction of benefits); if employee is active with at least 5 years of credited service, eligible survivor receives 75% of the benefit the employee would have received at age 62.
6. Contributions -
 - a. Employer - Determined by Board of Pension Trustees. Required to contribute 9.58% of its gross payroll for 2016.
 - b. Pre-2012 date of hire Member - 3% of earnings in excess of \$6,000.
 - c. Post-2011 date of hire Member – 5% of earnings in excess of \$6,000.
7. Burial Benefit- \$7,000 per member.

Note H - Employee Benefits – Continued

The Board of Pension Trustees issues a publicly available report, presented on the accrual basis of accounting, with detailed information about the Plan's fiduciary net position, including financial statements and required supplementary information. That report may be obtained by writing to the State of Delaware, Office of Pensions, McArdle Building, 860 Silver Lake Blvd., Suite 1, Dover, Delaware 19904 or by calling 1-800-722-7300.

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

Supplemental Information

Department of Natural Resources and Environmental Control

Hazardous Substance Cleanup Fund

Schedule of Revenues, Expenditure, and Change in Fund Balance by Account - Modified Cash Basis

For the Year Ended June 30, 2016

	<u>Administrative Account</u>	<u>Cleanup Account</u>	<u>Voluntary Cleanup Account</u>	<u>Total</u>
Revenues:				
Tax assessments	\$ -	\$ 7,345,782	\$ -	\$ 7,345,782
Cost recovery	412,108	-	-	412,108
Voluntary cleanup	-	-	248,470	248,470
Interest	-	167,070	5,272	172,342
Other	169,377	450	63	169,890
	<u>581,485</u>	<u>7,513,302</u>	<u>253,805</u>	<u>8,348,592</u>
Total Revenues				
	581,485	7,513,302	253,805	8,348,592
Expenditure:				
Cleanup program	<u>1,882,749</u>	<u>15,180,384</u>	<u>198,474</u>	<u>17,261,607</u>
	1,882,749	15,180,384	198,474	17,261,607
Net Change in Fund Balance	(1,301,264)	(7,667,082)	55,331	(8,913,015)
Fund Balance - Beginning of Year	<u>(2,330,447)</u>	<u>34,694,575</u>	<u>778,190</u>	<u>33,142,318</u>
	(2,330,447)	34,694,575	778,190	33,142,318
Fund Balance - End of Year	<u>\$ (3,631,711)</u>	<u>\$ 27,027,493</u>	<u>\$ 833,521</u>	<u>\$ 24,229,303</u>
	\$ (3,631,711)	\$ 27,027,493	\$ 833,521	\$ 24,229,303

Zelenkofske Axelrod LLC

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

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

We have audited, in accordance with the 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, the modified cash basis financial statements of the Department of Natural Resources and Environmental Control Hazardous Substance Cleanup Fund of the State of Delaware (the "Fund"), as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the Fund's basic financial statements – modified cash basis, and have issued our report thereon dated December 13, 2016.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements – modified cash basis, we considered the Fund's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements – modified cash basis, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the Fund's internal control.

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 Fund's financial statements – modified cash basis will not be prevented, or detected and corrected on a timely basis. 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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did identify a certain deficiency in internal control, described as finding 2016-001 in the accompanying schedule of findings and responses that we consider to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Fund's financial statements are free from 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 an instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards* and which is described as Finding 2016-001 in the accompanying schedule of findings and responses.

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Zelenkofske Axelrod LLC

The Fund's Response to Findings

The Fund's response to the finding identified in our audit is described in the accompanying schedule of findings and responses. The Fund's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Fund's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Fund's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Zelenkofske Axelrod LLC

ZELENKOFKSKE AXELROD LLC

Harrisburg, Pennsylvania
December 13, 2016

<u>Finding 2016-001</u>	<u>15% Administrative Cost Cap</u>
Criteria:	Title 7 Subsection 9113(d) of the State of Delaware code states, “No greater than 15% of the moneys deposited into the Fund shall be used for administering this chapter without approval of the Joint Finance Committee”.
Condition:	Costs charged to the Administrative Account for the year under audit amounted to 23% of the monies deposited into the Hazardous Substance Cleanup Fund, which exceeded the 15% cap by \$630,460. No approval was given from the Joint Finance Committee.
Cause:	The Delaware Department of Natural Resources and Environmental Control looks at the monies deposited and administrative costs on a cumulative basis over the life of the fund instead of on an annual basis when considering the 15% cap.
Effect:	Costs charged to the Administrative Account for the year under audit that exceeded the 15% cap by \$630,460 were potentially unallowed costs. The internal controls did not prevent the Fund from exceeding the administrative cap for a fiscal year.
Recommendation:	The Delaware Department of Natural Resources and Environmental Control should review the 15% cap on administrative costs on an annual basis, seeking approval from the Joint Finance Committee for amounts over the 15% cap, or seek revision to current legislation clarifying the 15% cap can be calculated on a cumulative basis over the life of the fund.
Management’s Response:	We have looked at the 15% cap on administrative costs to be cumulative over the life of the fund. Our records show that at the end of June 2016, the cumulative total for the administrative cap on total deposits was \$35,144,674 and the cumulative total spent for administrative costs to date was \$29,314,578. This leaves a total available for administrative costs of \$5,830,096.