

**AUDIT REPORT  
OF THE  
NEBRASKA DEPARTMENT OF  
ENVIRONMENTAL QUALITY  
CLEAN WATER  
STATE REVOLVING FUND PROGRAM  
JULY 1, 2003 THROUGH JUNE 30, 2004**

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**Issued on June 1, 2005**

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
CLEAN WATER STATE REVOLVING FUND PROGRAM

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NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
CLEAN WATER STATE REVOLVING FUND PROGRAM

**BACKGROUND**

The Nebraska Department of Environmental Quality - Clean Water State Revolving Fund Program (Program) was established pursuant to Title VI of the Federal Clean Water Act, as amended by the Water Quality Act of 1987. Neb. Rev. Stat. Sections 81-15,147 created the Wasterwater Treatment Facilities Construction Assistance Act. The Federal Water Quality Act and State statutes established the Clean Water State Revolving Fund Program to provide loans, at reduced interest rates, to finance the construction of publicly owned water pollution control facilities, non-point source pollution control projects, and estuary management plans. Instead of making grants to communities that pay for a portion of the building of wastewater treatment facilities, the Program provides for low interest loans to finance the entire cost of qualified projects. The Program provides a flexible financing source which can be used for a variety of projects. Loans made by the Program must be repaid within 20 years, and all repayments, including interest and principal, must remain in the Program, except interest used for debt service on match bonds.

The Program was capitalized by the United States Environmental Protection Agency (EPA) by a series of grants starting in 1989. States are required to provide an additional 20 percent of the Federal capitalization grant as matching funds in order to receive a Federal grant. As of June 30, 2004, the EPA had awarded over \$100 million in capitalization grants to the State. The award of this \$100 million required the State to contribute \$20 million in matching funds. The State provided appropriations to contribute \$.955 million of the funds to meet the State's matching requirement. Additional matching funds were obtained through the issuance of revenue bonds.

The Program is administered by the Nebraska Department of Environmental Quality (Department). The Department's primary activities with regard to the Program include the making of loans for water pollution control facilities and the management and coordination of the Program. The Nebraska Environmental Quality Council approves the rules and regulations of the Department and the Program's Intended Use Plan.

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**EXIT CONFERENCE**

An exit conference was held April 25, 2005 with the Department to discuss the results of our examination. Those in attendance for the Nebraska Department of Environmental Quality - Clean Water State Revolving Fund Program were:

<b>NAME</b>	<b>TITLE</b>
Tom Lamberson	Deputy Director - Administrator
Bart Moore	Budget Officer
Rick Bay	Financial Assistance Section Supervisor
Clyde Kramer	Federal Aid Administrator II

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**SUMMARY OF COMMENTS**

During our audit of the Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program, we noted certain matters involving the internal control over financial reporting and other operational matters which are presented here. Comments and recommendations are intended to improve the internal control over financial reporting, ensure compliance, or result in operational efficiencies.

1. ***Nebraska Information System and Accounting Procedures:*** Significant concerns or areas where improvement to the Nebraska Information System (NIS) is needed to ensure NIS integrity and operation efficiency were identified.

The following items were noted in the Statewide Single Audit:

2. ***Subrecipient Monitoring:*** A-133 single audit reports from subrecipients have not been reviewed since 2002 and the Department did not have controls in place to ensure all reports had been received.
3. ***Federal Cash Transactions Report:*** The Department did not prepare the semiannual report submitted in accordance with EPA calculations and instructions.

More detailed information on the above items is provided hereafter. It should be noted this report is critical in nature since it contains only our comments and recommendations on the areas noted for improvement.

Draft copies of this report were furnished to the Department to provide them an opportunity to review the report and to respond to the comments and recommendations included in this report. All formal responses received have been incorporated into this report. Where no response has been included, the Department declined to respond. Responses have been objectively evaluated and recognized, as appropriate, in the report. Responses that indicate corrective action has been taken were not verified at this time but will be verified in the next audit.

We appreciate the cooperation and courtesy extended to our staff during the course of the audit.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
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**COMMENTS AND RECOMMENDATIONS**

**1. Nebraska Information System and Accounting Procedures**

Good internal control requires a plan of organization, procedures, and records designed to safeguard assets and provide reliable financial records. Without adequate training, written procedures, and controls, there is a risk that employees may unintentionally corrupt critical data and that errors could occur and go undetected.

During the fiscal year ended June 30, 2003, the State of Nebraska implemented significant components of a new information system called the Nebraska Information System (NIS). Three major components were the Payroll, Fixed Asset, and Financial components, which went live during the fiscal year ended June 30, 2003. During the fiscal year ended June 30, 2004, the Procurement and Employee Self-Service components were partially implemented. NIS affects all Nebraska State agencies.

A consultant hired by the Auditor of Public Accounts (APA) with expertise in studying large computer systems performed a study of NIS processes and controls prior to June 30, 2003. The APA also performed a preliminary examination of internal controls as of June 30, 2003, at all State agencies in July and August of 2003. In addition, while performing examination procedures the APA obtained a further understanding of NIS.

From these studies and examinations, the APA has identified concerns and areas where improvement to NIS is needed. During the fiscal year ended June 30, 2004, the Department of Administrative Services (DAS) Accounting Division addressed some areas of concern previously reported. However, the following are the more significant concerns or areas where improvement is still needed to ensure NIS integrity and operational efficiency:

- a. The reconciliation between the State Treasurer's actual bank statements and records, the Nebraska Accounting System (NAS-the previous accounting system before NIS), NIS accounting records, and the related disposition of reconciling items was not completed for November 2002 through December 2003 in a timely manner. Subsequent to December 2003, the DAS Accounting Division performed some reconciliation procedures. As of July 2004, the June 30, 2003, reconciliation indicates an unknown variance between the bank records and the accounting records of \$3,654,783, with the bank being short compared to the accounting records.

During the fiscal year ended June 30, 2004, DAS Accounting Division began performing a daily reconciliation of activity recorded on NIS compared to the activity recorded in the bank on a limited test basis. For those days tested, the activity recorded on NIS can be reconciled to the activity in the bank. The monthly reconciliations for the months of July 2003 through February 2004 for the fiscal year ended June 30, 2004 have been performed and indicate fluctuations in the variance amounts. The latest monthly reconciliation performed, February 2004, indicates an unknown variance between the bank records and

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**COMMENTS AND RECOMMENDATIONS**

(Continued)

**1. Nebraska Information System and Accounting Procedures (Continued)**

the accounting records of \$5,112,201, with the bank being short compared to the accounting records. This variance was provided to us by DAS Accounting Division and its accuracy has not been verified by the APA.

Although some reconciliation procedures have been performed (daily reconciliation of activity going through NIS to the activity recorded through the bank), the monthly reconciliation for the months March 2004 through June 2004 are still in the preliminary stages and are not complete as of July 2004. Complete and timely reconciliation procedures between bank records and accounting records provide control over cash and accurate financial information. The reconciliation procedures should be completed timely and on at least a monthly basis to ensure all financial information is correct in NIS.

- b. During the early implementation months of NIS, DAS Accounting Division did not have a comprehensive written NIS policy and procedures manual available for users. During the fiscal year ended June 30, 2004, DAS Accounting Division made progress in this area and significant policies and procedures can be found by users on the DAS Accounting Division website. However, the APA, after reviewing the old accounting procedures manual, did note some procedures still being performed under those policies that have not been incorporated as NIS policies. We recommend DAS Accounting Division continue to update their NIS policies and procedures to include all policies and procedures in place to help ensure consistent and accurate accounting of the State's financial transactions.
- c. During the early implementation of NIS it was determined the NIS Payroll application was not allocating salaries and benefits appropriately to salaried employees who incur hours that are distributed across multiple business units. This would apply to many State agencies' funds, programs, and grants. During the fiscal year ended June 30, 2004, agencies including DEQ developed "work around" solutions to this problem, however, there has been no system change to resolve this problem. The "work around" solutions can be very time consuming. We recommend DAS Accounting Division consider obtaining a system change to allocate salaries and benefits appropriately for salaried employees who incur hours that are distributed across multiple business units.
- d. During the first year of NIS implementation an outside consultant noted a detailed analysis had not been performed to determine whether users received adequate training to enable them to appropriately perform their job functions. The APA is not aware of any detailed analysis of user training conducted by the DAS Accounting Division during the fiscal year ended June 30, 2004, but does acknowledge a significant training effort by the DAS Accounting Division during this period. We recommend the DAS Accounting Division continue their training efforts as well as identifying user training needs.

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**COMMENTS AND RECOMMENDATIONS**

(Continued)

**1. Nebraska Information System and Accounting Procedures (Continued)**

- e. Since the implementation of NIS, DAS Accounting Division has not updated their records retention and disposition schedule with the Records Management Division of the Secretary of State. The records retention schedule on file with the Secretary of State covers the records under the old accounting system and was last updated in 1986.

Neb. Rev. Stat. Section 84-1207 R.R.S. 1999 states the head of any State agency shall make, and submit to the State Records Administrator schedules proposing the length of time each record series warrants retention for administrative, legal, historical or fiscal purposes, after it has been made in or received by the agency, and lists of records in the custody or under the control of the agency which are not needed in the transaction of current business, and do not possess sufficient administrative, legal, historical or fiscal value to warrant their further retention.

Since many of the records (and their titles) are significantly different under NIS than they were under the old accounting system we do not believe the DAS Accounting Division is in compliance with the above statute with the current retention schedule on file with the Secretary of State. In addition, for legal purposes and for good business practices we believe a comprehensive DAS Accounting Division records retention schedule is imperative. We recommend the DAS Accounting Division work with the Secretary of State to develop a comprehensive records retention schedule for all records they maintain.

- f. The payroll component is not designed to promote an effective segregation of duties. We recommend the DAS Accounting Division consider implementing the compensating control as identified in the k. section of this comment. DEQ has implemented compensating controls.
- g. During the first year of NIS implementation an outside consultant noted access to sensitive General Accounting functions had been provided to individuals who may not require such access as a part of their job responsibilities. Based on our inquiries, DAS Accounting Division management noted, "All critical function access rights have been secured down to the appropriate high level matrix codes." We could not verify the accuracy of this statement as requested information and documentation have not been provided to us.
- h. During the first year of NIS implementation an outside consultant noted the State had not documented or formalized comprehensive information security procedures for NIS. Based on our inquiries, DAS Accounting Division management noted, "The NIS CNC's and the NIS Security team have developed a comprehensive security policy." We could not verify the accuracy of this statement as requested information and documentation have not been provided to us.

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**COMMENTS AND RECOMMENDATIONS**

(Continued)

**1. Nebraska Information System and Accounting Procedures (Continued)**

- i. During the first year of NIS implementation an outside consultant noted the State had not implemented a formal, comprehensive business continuity or disaster recovery plan that comprehends both NIS and its supporting infrastructure. Based on our inquiries, DAS Accounting Division management noted, "We have now contracted with an outside vendor for business continuity planning." Documentation provided to us by DAS management indicates the State has a disaster recovery plan, however, it is not complete and the business continuity plan is in the draft stage but has not yet been tested. We recommend the State continue to implement formal, comprehensive business continuity and disaster recovery plans.
- j. The APA reviewed certain data in the NIS address book in July 2004. We noted the following related vendor information:
  1. Duplicate Name and Address – Our review noted a total of 4,435 duplicate records. However, all have different address book numbers.
  2. Duplicate Bank Information – 4,118 vendors had duplicate bank information.
  3. Vendors with no Federal Tax Identification Number (FTIN) in NIS and Vendors with an FTIN of 000000000 – 3,789 vendors either had no FTIN or an FTIN with all zeros. The vendors with zeros as their FTIN were all PW (welfare) vendor types. Out of the 3,789 records 3,408 had no FTIN at all.

When duplicate records are in the NIS address book database there is a greater risk of duplicate payments being made and not being detected and queries of the database for vendor information may not be complete because the queries may not include all vendor information. In addition, when the database does not include FTIN numbers for all vendors there is a greater risk of payments to a fictitious vendor. DAS Accounting Division should correct the database for duplicate records and ensure all vendors included in the database have an FTIN.

- k. DAS Accounting Division payroll procedures require each State agency to certify its payroll for each pay period to ensure payroll is processed accurately and completely. This certification is to be in writing, either through an email or letter to the DAS Accounting Administrator. In our review of the final payroll notification and certification procedures processed in July 2003 and May of 2004 and discussion with DAS Accounting Division personnel, the certification procedures were not always performed. Our review also noted that the DAS Accounting Division did not have a

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**COMMENTS AND RECOMMENDATIONS**

(Continued)

**1. Nebraska Information System and Accounting Procedures (Concluded)**

policy on the information that should be included in the written certification. We noted during our testing, when there was a certification, there was no consistency in the information provided by State agencies.

DAS Accounting Division should establish a policy on detailing the information to be included in the certification, should ensure all State agencies consistently follow this policy, and ensure all payroll expenditures are certified.

The issues identified above are the responsibility of the DAS Accounting Division and NIS Functional Team as they relate directly to NIS; however, they directly affect all Nebraska State agencies' financial information and must be disclosed in this report. The results of the consultant's study of NIS were communicated in a separate report to DAS, who is responsible for NIS. Letters to each State agency communicated the results of the APA's preliminary examination of internal controls at the State agency level. Additional concerns identified by the APA were communicated to the appropriate State officials.

**2. Subrecipient Monitoring**

A pass-through entity is responsible for:

- *Award Identification* – At the time of the award, identifying to the subrecipient the Federal award information (e.g., CFDA title and number, award name, name of Federal agency) and applicable compliance requirements.
- *During-the-Award Monitoring* – Monitoring the subrecipient's use of Federal awards through site visits or other means to provide reasonable assurance that the subrecipient administers Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved.
- *Subrecipient Audits* – Ensuring required audits are completed within nine months of the end of the subrecipient's audit period, issuing a management decision on audit findings within six months after receipt of the subrecipient's audit report, and ensuring that the subrecipient takes timely and appropriate corrective action on all audit findings. In cases of continued inability or willingness of a subrecipient to have the required audits, the pass-through entity shall take appropriate action using sanctions.
- *Pass-Through Entity Impact* – Evaluating the impact of subrecipient activities on the pass-through entity's ability to comply with applicable Federal regulations.

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**COMMENTS AND RECOMMENDATIONS**

(Continued)

**2. Subrecipient Monitoring (Concluded)**

The Department did not obtain all required A-133 reports from subrecipients, review the A-133 reports, or follow-up on findings and related corrective action. The Department has obtained A-133 single audit reports from subrecipients; however, they have not been reviewed since 2002 and do not have controls in place to ensure they have received all the reports. The Department does perform on-site and desk reviews to monitor their subrecipients' annual activity, but does not ensure proper follow-up is conducted on the subrecipients' A-133 single audit reports. During fiscal year 2004, there were 24 recipients receiving \$5,443,302 for the Clean Water program.

The Department is not in compliance with subrecipient monitoring requirements and is unable to provide assurance that the subrecipients are in compliance with Federal requirements.

We recommend the Department continue to refine its centralized monitoring procedures and develop a monitoring tool, as well as written policies and procedures, to ensure that all required single audit reports are received and reviewed and appropriate action is taken on any findings noted within time requirements.

*Department's Response: The Department will review the monitoring procedures in place for all programs that have subrecipients. We will implement the Techniques for Monitoring Federal Subawards document. Within the SRF program the agency will work toward ensuring that applicable A-133 audit reports are being received and reviewed, and necessary follow up work will be documented. The Department is performing site financial reviews of program activities and are documenting those reviews as they are completed.*

**3. Federal Cash Transactions Report**

The U.S. Environmental Protection Agency (EPA) Electronic Funds Transfer Payment Process Recipients' Manual requires semiannual submission of the SF-272, *Federal Cash Transactions Report*, to the EPA 15 days after the periods ending June 30 and December 31.

The SF-272, *Federal Cash Transactions Report*, for the period from July 1, 2003 through December 31, 2003 was not prepared in a manner consistent with the manner in which the EPA requires the form to be prepared.

We recommend the Department ensure reports are completed and filed with the Federal agency in accordance with Federal requirements.

# STATE OF NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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## NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY CLEAN WATER STATE REVOLVING FUND PROGRAM

### INDEPENDENT AUDITORS' REPORT

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We have audited the accompanying financial statements of the business-type activities of the Nebraska Department of Environmental Quality - Clean Water State Revolving Fund Program (Program), as of and for the year ended June 30, 2004, as listed in the Table of Contents. These financial statements are the responsibility of the Program's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Nebraska Department of Environmental Quality - Clean Water State Revolving Fund Program, and are not intended to present fairly the financial position and results of operations of the Nebraska Department of Environmental Quality - Clean Water State Revolving Fund Program in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of the Nebraska Department of Environmental Quality - Clean Water State Revolving Fund Program, as of June 30, 2004, and the respective changes in financial position and cash flows thereof 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 25, 2005, on our consideration of the Nebraska Department of Environmental Quality - Clean Water State Revolving Fund Program's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of 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.

In accordance with the *U.S. Environmental Protection Agency Audit Guide for Clean Water and Drinking Water State Revolving Fund Programs*, we have also issued our report dated April 25, 2005 on our consideration of the Nebraska Department of Environmental Quality - Clean Water State Revolving Fund Program's compliance with certain provisions of laws, regulations, and grants.

Our audit was performed for the purpose of forming an opinion on the financial statements of the Department of Environmental Quality - Clean Water State Revolving Fund Program taken as a whole. Management's Discussion and Analysis is presented for purposes of additional analysis and is not a required part of the basic financial statements. The Management's Discussion and Analysis has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

April 25, 2005

Pat Reding, CPA  
Assistant Deputy Auditor

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**MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)**

This section of the Nebraska Department of Environmental Quality - Clean Water State Revolving Fund Program's (Program) financial report presents a narrative overview and analysis of the financial activities of the Program for the fiscal year ended June 30, 2004. This analysis has been prepared by management of the Program and is intended to be read with the financial statements and related footnotes that follow this section.

**OVERVIEW OF THE FINANCIAL STATEMENTS**

This discussion and analysis is intended to serve as an introduction to the Program's basic financial statements. The Program's basic financial statements include: 1) Balance Sheet, 2) Statement of Revenues, Expenses, and Changes in Net Assets, 3) Statement of Cash Flows, and 4) Notes to Financial Statements.

The Balance Sheet presents information on all of the Program's assets and liabilities, with the difference between the two reported as net assets.

The Statement of Revenues, Expenses, and Changes in Net Assets presents information showing how the Program's net assets changed during the most recent fiscal year.

The Statement of Cash Flows presents the Program's flows of cash by defined categories. The primary purpose of the Statement of Cash Flows is to provide information about the Program's cash receipts and payments during the year.

The Notes to Financial Statements provide additional information that is essential to a full understanding of the data provided in the financial statements.

**ANALYSIS OF BALANCES AND TRANSACTIONS OF ENTERPRISE FUND**

**Changes in Net Assets**

For the fiscal year ended June 30, 2004, net assets of the Program increased by approximately 8%.

	<u>2004</u>	<u>2003</u>
<b>Current Assets</b>	\$ 61,219,110	\$ 45,808,345
<b>Noncurrent Assets</b>	79,631,862	83,852,708
Total Assets	<u>140,850,972</u>	<u>129,661,053</u>
<b>Current Liabilities</b>	1,166,489	84,308
<b>Noncurrent Liabilities</b>	-	-
Total Liabilities	<u>1,166,489</u>	<u>84,308</u>
<b>Net Assets</b>		
Unrestricted	139,684,483	129,576,745
Total Net Assets	<u>\$ 139,684,483</u>	<u>\$ 129,576,745</u>

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**MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)**  
(Continued)

	<u>2004</u>	<u>2003</u>
<b>Operating Revenues</b>	\$ 5,730,175	\$ 5,498,176
<b>Operating Expenses</b>	<u>1,146,170</u>	<u>961,596</u>
<b>Operating Income</b>	4,584,005	4,536,580
<b>Capital Federal Grants</b>	5,523,733	4,094,787
<b>Cash Transfers Out</b>	<u>-</u>	<u>(122,667)</u>
<b>Change in Net Assets</b>	10,107,738	8,508,700
<b>Net Assets, Beginning of Year</b>	<u>129,576,745</u>	<u>121,068,045</u>
<b>Net Assets, End of Year</b>	<u>\$ 139,684,483</u>	<u>\$ 129,576,745</u>

The most significant changes from the fiscal year ended June 30, 2003 to the fiscal year ended June 30, 2004, include increases in cash in the State Treasury and decreases to loans receivable.

One bond was issued during the fiscal year. The Department of Environmental Quality has entered into a special financing arrangement with the Nebraska Investment Finance Authority (NIFA) to provide matching funds for the Program. NIFA issues the bonds and proceeds are held by the Trustee until needed for loan purposes. The 2004B Series Bonds were issued during the fiscal year for \$1,125,000.

Loans receivable decreased by approximately \$5.8 million during the fiscal year. The City of Kearney, Aurora, Lexington, and Omaha made principal payments which resulted in loans receivable decreasing by approximately \$11.7 million. There was also an increase of seven new loan balances as of June 30, 2004.

See the Notes to Financial Statements for additional discussion of bond issuances and loans receivable.

**ECONOMIC OUTLOOK**

No conditions were noted that would be expected to have a significant effect on the financial position or results of operations of the Program.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
CLEAN WATER STATE REVOLVING FUND PROGRAM  
**BALANCE SHEET**  
June 30, 2004

	Enterprise Fund
<b>ASSETS</b>	
CURRENT ASSETS	
Cash & Cash Equivalents:	
Cash in State Treasury (Note 2)	\$ 54,274,225
Deposits Held by Trustee (Note 2)	23,600
Short Term Investments Held by Trustee (Note 2)	1,125,000
Loans Receivable - Current (Note 3)	5,796,285
<b>TOTAL CURRENT ASSETS</b>	<b>61,219,110</b>
NON-CURRENT ASSETS	
Loans Receivable (Note 3)	79,631,862
<b>TOTAL NON-CURRENT ASSETS</b>	<b>79,631,862</b>
<b>TOTAL ASSETS</b>	<b>\$ 140,850,972</b>
 <b>LIABILITIES</b>	
CURRENT LIABILITIES	
Accounts Payable	\$ 17,889
Accrued Bond Interest Payable - Current	19,600
Cost of Issuance Payable - Current	4,000
Bonds Payable - Current (Note 4)	1,125,000
<b>TOTAL CURRENT LIABILITIES</b>	<b>1,166,489</b>
 <b>NET ASSETS</b>	
Unrestricted	139,684,483
<b>TOTAL NET ASSETS</b>	<b>139,684,483</b>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<b>\$ 140,850,972</b>

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

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
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**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS**  
 For the Year Ended June 30, 2004

	Enterprise Fund
<b>OPERATING REVENUES:</b>	
Loan Fees Administration (Note 6)	\$ 865,544
Interest on Loans	2,976,836
Interest on Fund Balance -Trustee	15
Sale of Fixed Assets	11
Examination Fees	(150)
Interest on Fund Balance (Note 7)	1,778,970
Other	108,949
<b>TOTAL OPERATING REVENUES</b>	<b>5,730,175</b>
 <b>OPERATING EXPENSES:</b>	
Administrative Costs	573,914
Small Town Grants (Note 8)	548,656
Interest Expense-State Match Bonds	19,600
Cost of Bond Issuance	4,000
<b>TOTAL OPERATING EXPENSES</b>	<b>1,146,170</b>
 <b>OPERATING INCOME</b>	<b>4,584,005</b>
 <b>CAPITAL CONTRIBUTIONS</b>	<b>5,523,733</b>
<b>CHANGE IN NET ASSETS</b>	<b>10,107,738</b>
<b>TOTAL NET ASSETS, BEGINNING OF YEAR</b>	<b>129,576,745</b>
 <b>TOTAL NET ASSETS, END OF YEAR</b>	<b>\$ 139,684,483</b>

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

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
CLEAN WATER STATE REVOLVING FUND PROGRAM  
**STATEMENT OF CASH FLOWS**  
For the Year Ended June 30, 2004

	Enterprise Fund
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>	
Receipts From Customers	\$ 22,267,103
Deposits with Trustee	16,227
Short Term Investments Held by Trustee	1,125,000
Interest on Investments	1,778,985
Payments to Borrowers	(12,643,326)
Payments to Employees and Vendors	(573,914)
Small Town Grants	(548,656)
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>11,421,419</b>
 <b>CASH FLOWS FROM NON-CAPITAL &amp; RELATED FINANCING ACTIVITIES:</b>	
NIS Corrections	57,268
Funds Received From the Environmental Protection Agency	5,466,465
<b>NET CASH FROM NON-CAPITAL &amp; RELATED FINANCING ACTIVITIES</b>	<b>5,523,733</b>
 <b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	<b>38,477,673</b>
 <b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>	<b>\$ 55,422,825</b>
 <b>RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:</b>	
Operating Income	\$ 4,584,005
<b>ADJUSTMENTS TO RECONCILE OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:</b>	
Decrease in Loans Receivable	5,755,233
Increase in Bonds Payable	1,125,000
Increase in Accrued Bond Interest Payable	19,600
Increase in Cost of Issuance Payable	4,000
Decrease in Accounts Payable	(66,419)
 <b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>\$ 11,421,419</b>

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

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
CLEAN WATER STATE REVOLVING FUND PROGRAM

**NOTES TO FINANCIAL STATEMENTS**

For the Fiscal Year Ended June 30, 2004

**1. Summary of Significant Accounting Policies**

- A. Basis of Presentation.** The accompanying financial statements of the Nebraska Department of Environmental Quality (Department) - Clean Water State Revolving Fund Program (Program) have been prepared in conformance with generally accepted accounting principles (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

The financial statements have been prepared primarily from accounts maintained by the State Accounting Administrator of the Department of Administrative Services.

- B. Reporting Entity.** The Clean Water State Revolving Fund Program is a program within the Department and is established under and governed by the Clean Water Act of the Federal Government and by laws of the State of Nebraska. The Department is a State agency established under and governed by the laws of the State of Nebraska. As such, the Department is exempt from State and Federal income taxes. The Program's management has also considered all potential component units of the Program for which it is financially accountable, and other organizations which are fiscally dependent on the Program's management, or the significance of their relationship with the Program's management are such that exclusion would be misleading or incomplete. GASB has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body and (1) the ability of the Department to impose its will on that organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the Department.

As required by generally accepted accounting principles, these financial statements present the Nebraska Department of Environmental Quality - Clean Water State Revolving Fund Program. No component units were identified. The Program is part of the primary government for the State of Nebraska's reporting entity.

- C. Fund Structure.** The Program's accounts are maintained in accordance with the principles of fund accounting to ensure compliance with limitations and restrictions placed on the use of resources available to it. Under fund accounting, individual funds are established for the purpose of carrying on activities or attaining objectives in accordance with specific regulations, restrictions, or limitations. Each individual fund is a self-balancing set of accounts recording

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
CLEAN WATER STATE REVOLVING FUND PROGRAM

**NOTES TO FINANCIAL STATEMENTS**

(Continued)

**1. Summary of Significant Accounting Policies** (Continued)

cash and other financial resources, together with liabilities and residual equities or balances, and changes therein. The Program is made up of four funds on the State of Nebraska Accounting System. It includes the following funds as identified in the Wastewater Treatment Facilities Construction Assistance Act:

- Clean Water Facilities Funds – General Fund 10000, Federal Funds 48412 and 48413, and Bond Funds 68470, 68471, 68472, and 68473.
- Administration Funds – Cash Funds 28460, 28461, and 28462.

These funds are used to account for revenues and expenses for loans and administrative expenses of the Program.

The activity of these ten State of Nebraska funds have been combined and reported as an enterprise fund, which under governmental GAAP is a proprietary fund type. This fund type reflects transactions used to account for those operations that are financed and operated in a manner similar to a private business. The accounting for the Program's transactions in this manner is a requirement of the Environmental Protection Agency (EPA) as they and the Department have decided that the determination of revenues earned, expenses incurred, and/or net income is necessary to demonstrate the success of the Program and to assure the EPA the Program will be available in perpetuity as intended.

- D. Basis of Accounting.** The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. An enterprise fund is accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation of the fund are included on the balance sheet. Enterprise fund operating statements present increases (i.e., revenues) and decreases (i.e., expenses) in net total assets.

Enterprise funds utilize the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

In reporting the financial activity of its enterprise fund, the Program's management applied all applicable GASB pronouncements as well as the following pronouncements issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinion, and Accounting Research Bulletins of the Committee on Accounting Procedures.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
CLEAN WATER STATE REVOLVING FUND PROGRAM

**NOTES TO FINANCIAL STATEMENTS**

(Continued)

**1. Summary of Significant Accounting Policies** (Concluded)

**E. Cash and Cash Equivalents.** Cash in State Treasury is maintained in a short term investment pool and is considered cash equivalents.

**F. Loans Receivables.** The State operates the Program as a direct loan program, whereby loans are made to communities. The entire Clean Water Program is funded, on average, 83.33% from Federal capitalization grants and 16.67% from State matching funds. Loan funds are disbursed to the local agencies as they expend funds for the purposes of the loan. Interest is calculated from the date funds are advanced, and after the final disbursement has been made, the payment schedule identified in the loan agreement is adjusted for the actual amounts disbursed, and accrued interest during the project period. The interest rates on loans range from 2.5% to 5.25% and the terms are between 10 to 20 years. The current loans receivable amount was determined using the amount of principal payment due to the Program at June 30, 2004, which is collectible in fiscal year 2005.

No provisions were made for uncollectible accounts as all loans were current, and management believed all loans would be repaid according to the loan terms. There was a provision for the Program to intercept State aid to a community in default of its loan.

**G. Accounts Payable.** A cutoff is made on July 31<sup>st</sup> of each year when determining the amount of accounts payable that exists for the current year. Any information that would change this figure will be disregarded and shown as an expense of the year the payment is made and not when the liability is incurred.

**2. Cash and Cash Equivalents**

Cash in State Treasury as reported on the balance sheet is under the control of the State Treasurer or other administrative bodies as determined by law. All cash deposited with the State Treasurer is maintained in a short-term investment pool. The State Investment Officer invests the deposited cash in short-term securities and other investments. All interest revenue is allocated to the general fund except allocations required by law to be made to other funds. All funds of the Clean Water State Revolving Fund Program were designated for investment during fiscal year 2004. Amounts are allocated on a monthly basis based on average balances of all invested funds.

**Deposits Held by Trustee and Investments Held by Trustee.** The Nebraska Investment Finance Authority (NIFA) (the "Issuer") issues revenue bonds payable by the Department from certain portions of the fund (see Note 4 Bonds Payable) to provide additional funds to meet the 20% match requirements of the Capitalization Grants. Wells

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
CLEAN WATER STATE REVOLVING FUND PROGRAM

**NOTES TO FINANCIAL STATEMENTS**

(Continued)

**2. Cash and Cash Equivalents** (Concluded)

Fargo Bank Iowa, National Association, (Trustee), as trustee, holds these accounts. The Trustee, in accordance with the Bond Indenture, establishes the appropriate accounts and invests the monies. At June 30, 2004, the cash held by the trustee of \$1,148,602 stated at Fair Market Value, was invested in a money market account.

In accordance with GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*, deposits and investments are to be categorized as to custodial credit risk. The money market accounts with a carrying amount of \$1,148,602 were uninsured and uncollateralized during and at the end of fiscal year 2004.

**3. Loans Receivable**

As of June 30, 2004, the Program had outstanding loans with 102 communities that totaled \$85,428,147. The outstanding balances of the ten communities with the largest SRF debt, which represent 45.0% of the total loans, were as follows:

City	Outstanding Balance
Omaha	\$ 9,560,458
Gibbon	6,642,741
Wahoo	4,415,601
Scottsbluff	3,697,624
Fremont	2,884,831
Sarpy County SID #1	2,423,592
Kearney	2,420,393
Central City	2,146,208
David City	2,142,106
Ogallala	2,130,753
Total	\$ 38,464,307

**4. Bonds Payable**

The Environmental Protection Agency (EPA) requires the Program to provide matching funds. During the fiscal year, the Program issued \$1,125,000 in short-term revenue bonds to meet this requirement.

The State has entered into a special financing arrangement with NIFA, an independent instrumentality of the State exercising essential public functions, to provide matching funds for the State's Clean Water Program. NIFA issues the bonds and the proceeds are held by the Trustee until they are needed by the Program for loan purposes. The

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
CLEAN WATER STATE REVOLVING FUND PROGRAM

**NOTES TO FINANCIAL STATEMENTS**

(Continued)

**4. Bonds Payable** (Concluded)

Series 2004B Bonds are limited obligations of NIFA, payable only from and secured only by the Trust Estate. The Series 2004B Bonds are revenue bonds. The Series 2004B Bonds shall not constitute a debt, liability, general obligation of the State, or a pledge of the faith and Credit of the State, but are payable solely out of the revenue or money NIFA pledged to the Trust Estate. Neither the faith and credit nor the taxing power of the State is pledged to the principal of, premium, if any, or the interest on the Series 2004B Bonds. The current bonds payable amount was determined using the amount of bond principal issued in fiscal year 2004. Series 2004B Bonds will mature on June 1, 2005. The principal has been prepaid and is included in the Deposits and Investments Held by Trustee. Bonds payable for the fiscal year ended June 30, 2004, is as follows:

	Beginning Balance	Additions	Retirement	Ending Balance
Bonds Payable	\$ -	\$ 1,125,000	\$ -	\$ 1,125,000
	-	1,125,000	-	1,125,000

**5. Net Assets**

Included in the Net Assets is the total amount of capitalization grants drawn from the EPA by the Department. The following summarizes the capitalization grants awarded, drawn, and the remaining balance as of June 30, 2004.

Year	Grant Amount	Amount Drawn	Balance
1989	\$ 4,773,100	\$ 4,773,100	\$ -
1990	4,964,560	4,964,560	-
1991	10,821,580	10,821,580	-
1992	9,938,500	9,938,500	-
1993	9,830,300	9,830,300	-
1994	6,061,600	6,061,600	-
1995	6,263,600	6,263,600	-
1996	10,319,661	10,319,661	-
1997	3,119,900	3,119,900	-
1998	7,019,996	7,019,996	-
1999	6,857,600	6,857,600	-
2000	6,834,000	6,834,000	-
2001	6,797,400	6,797,400	-
2002	6,855,000	6,843,180	11,820
2003	7,069,900	5,410,985	1,658,915
Totals	\$ 107,526,697	\$ 105,855,962	\$ 1,670,735

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
CLEAN WATER STATE REVOLVING FUND PROGRAM

**NOTES TO FINANCIAL STATEMENTS**

(Continued)

**5. Net Assets** (Concluded)

The following is a summary of changes in the total contributed capital.

Contributed Capital July 1, 2003	\$ 101,344,437
Contributed During the Year - Funds	
Received From EPA	5,466,465
Contributed Capital June 30, 2004	<u>\$ 106,810,902</u>

Also included in the Contributed Capital is a total of all general funds received by the Program from the Legislature of the State of Nebraska. These assets were to be used as match for the Program for the initial capitalization grant received by the State. The State contributed \$300,000 and \$655,000 in fiscal years ended June 30, 1989 and 1990, respectively.

**6. Loan Fees Administration**

The reported amount comes from a fee charged to loan recipients each year based on the amount of the loan outstanding. The fee ranged from .5% to 1% per annum and was collected semi-annually. Of the total collected, \$269,884 will be used as match for the fiscal year 2004 capitalization grant.

**7. Interest on Fund Balance Held by State Treasurer**

The reported amount represents the earnings the Program has received from idle funds invested by the Treasurer of the State of Nebraska. Interest is credited on approximately the twenty-fifth day of each subsequent month.

**8. Small Town Grants**

Small Town Grants are made to communities that have a population of 5,000 people or less. The total maximum of Small Town Grants awarded in any one fiscal year is \$500,000. The maximum a community can receive is \$100,000 concurrent with a Program loan. The Loan Fees Administration is used to fund these grants.

**9. Operating Revenues and Expenses**

Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the Program's principal ongoing operations. The principal operating revenue of the Program is the Loan Fees Administration. Interest revenues are also operating revenues since making loans is the primary purpose of the Program. The principal operating expenses of the Program are administration expenses and small town grants. Interest expenses are also operating expenses since making loans is the primary purpose of the Program.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
CLEAN WATER STATE REVOLVING FUND PROGRAM

NOTES TO FINANCIAL STATEMENTS

(Continued)

10. State Employees' Retirement Plan (Plan)

The single-employer plan became effective by statute on January 1, 1964. Prior to January 1, 2003 the plan consisted of a defined contribution plan that covered State employees. Effective January 1, 2003, a cash balance benefit was added to the State Employees Retirement Act. The cash balance benefit is a type of defined benefit plan. Each member employed and participating in the retirement system prior to January 1, 2003, elected to either continue participation in the defined contribution benefit or begin participation in the cash balance benefit. The defined contribution benefit is closed to new entrants. All new members of the Plan on and after January 1, 2003, become members of the cash balance benefit. The benefits and funding policy of the Plan is established and can only be amended by the Nebraska Legislature.

All permanent full-time employees who have 12 continuous months of service are required to begin participation in the retirement system. All permanent full-time or permanent part-time employees who have 12 months of service within a five-year period, and who have attained the age of 20, may exercise the option to begin participation in the retirement system.

**Contribution.** Each member contributes 4.33% of his or her monthly compensation until \$864 has been contributed and 4.8% of pay for the rest of the calendar year. The Department matches the member's contribution at a rate of 156%. The employee's and employer's contributions are kept in separate accounts.

The employee's account is fully vested. The employer's account is vested 100% after a total of three years of participation in the system, including the twelve-month eligibility period or credit for participation in another governmental plan prior to actual contribution to the Plan.

**Defined Contribution Benefit.** Upon attainment of age 55, regardless of service, the retirement allowance shall be equal to the sum of the employee and employer account. Members have several forms of payment available, including withdrawals, deferrals, annuities, or a combination of these.

**Cash Balance Benefit.** Upon attainment of age 55, regardless of service, the retirement allowance shall be equal to the accumulated employee and employer cash balance accounts, including interest credits, annuitized for payment in the normal form. The normal form of payment is a single life annuity with five year certain, payable monthly. Members will have the option to convert their member cash balance account to a monthly annuity with built in cost-of-living adjustments of 2.5% annually. Also available are additional forms of payment allowed under the Plan which are actuarially equivalent to the normal form, including the option of lump-sum or partial lump-sum.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
CLEAN WATER STATE REVOLVING FUND PROGRAM

**NOTES TO FINANCIAL STATEMENTS**

(Continued)

**10. State Employees' Retirement Plan (Plan)** (Concluded)

For the fiscal year ended June 30, 2004, the Clean Water State Revolving Fund Program's employees contributed \$15,064 and the Department contributed \$23,499. A separate plan report is issued and can be obtained from the Nebraska Public Employees Retirement System. This report contains full pension-related disclosures.

**11. Contingencies and Commitments**

**Risk Management.** The Department is exposed to various risks of loss related to torts, theft of, damage to, and destruction of assets, errors and omissions, injuries to employees, and natural disasters. The Department, as part of the primary government for the State, participates in the State's risk management program. The Nebraska Department of Administrative Services (DAS) Division of Risk Management is responsible for maintaining the insurance and self-insurance programs for the State with the exception of the health and life insurance programs which are maintained by the DAS Personnel Division. The State has chosen to purchase insurance for:

- A. Motor vehicle liability, which is insured for the first \$5 million of exposure per accident with a self-insured retention of \$300,000 per accident, except for accidents involving vehicular pursuit which have a \$1,000,000 self-insured retention per accident. Insurance is also purchased for medical payments, physical damage, and uninsured and underinsured motorists with various limits and deductibles. State agencies have the option to purchase coverage for physical damage to vehicles.
- B. Health care and life insurance for eligible employees.
- C. Crime coverage, with a limit of \$1 million for each loss, and a \$25,000 self-insured retention per incident.
- D. Real and personal property on a blanket basis for losses up to \$100,000,000, with a self-insured retention of \$200,000 per loss occurrence. Newly acquired properties are covered up to \$1,000,000 for 60 days or until the value of the property is reported to the insurance company. The perils of flood and earthquake are covered up to \$10,000,000. Acts of terrorism are covered up to \$2,500,000 aggregate per year. State agencies have the option to purchase building contents and inland marine coverage.

No settlements exceeded commercial insurance coverage in any of the past three fiscal years. Health care insurance is funded in the Compensation Insurance Trust Fund through a combination of employee and State contributions. Workers' compensation is also funded in the Workers' Compensation Internal Service Fund through assessments on

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
CLEAN WATER STATE REVOLVING FUND PROGRAM

**NOTES TO FINANCIAL STATEMENTS**

(Continued)

**11. Contingencies and Commitments** (Concluded)

each agency based on total agency payroll and past experience. Tort claims, theft of, damage to, or destruction of assets, errors and omissions, and natural disasters would be funded through the State General Fund or by individual agency assessments as directed by the Legislature, unless covered by purchased insurance. No amounts for estimated claims have been reported in the Nebraska Department of Environmental Quality - Clean Water State Revolving Fund's financial statements.

# STATE OF NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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**NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
CLEAN WATER STATE REVOLVING FUND PROGRAM  
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**

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Nebraska Department of Environmental Quality  
Lincoln, Nebraska

We have audited the financial statements of the Nebraska Department of Environmental Quality - Clean Water State Revolving Fund Program as of and for the year ended June 30, 2004, and have issued our report thereon dated April 25, 2005. The Independent Auditors' Report was modified to emphasize the financial statements present only the funds of the Nebraska Department of Environmental Quality - Clean Water State Revolving Fund Program. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

#### Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Nebraska Department of Environmental Quality - Clean Water State Revolving Fund Program's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted a certain matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Nebraska Department of Environmental Quality - Clean Water State Revolving Fund Program's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. A reportable condition is described in the Comments Section of the report as Comment Number 1 (Nebraska Information System and Accounting Procedures).

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe the reportable condition described above is not a material weakness.

#### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Nebraska Department of Environmental Quality - Clean Water State Revolving Fund Program's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We also noted an additional item that we have reported to management of the Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program in a separate letter dated April 25, 2005.

This report is intended solely for the information and use of the Program, the appropriate Federal and regulatory agencies. However, this report is a matter of public record and its distribution is not limited.

Pat Reding, CPA

Assistant Deputy Auditor

April 25, 2005

# STATE OF NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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**NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
CLEAN WATER STATE REVOLVING FUND PROGRAM  
REPORT ON COMPLIANCE AND ON INTERNAL CONTROL  
OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO  
THE NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
CLEAN WATER STATE REVOLVING FUND PROGRAM  
IN ACCORDANCE WITH U.S. ENVIRONMENTAL PROTECTION  
AGENCY AUDIT GUIDE FOR CLEAN WATER AND DRINKING  
WATER STATE REVOLVING FUND PROGRAMS**

Nebraska Department of Environmental Quality  
Lincoln, Nebraska

We have audited the compliance of the Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program with the types of compliance requirements described in the *U.S. Environmental Protection Agency Audit Guide for Clean Water and Drinking Water State Revolving Fund Programs* that were applicable for the year ended June 30, 2004. We audited the Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program’s compliance with requirements governing: Allowability for Specific Activities, Allowable Costs/Cost Principles, Cash Management, State Matching, Period of Availability of Funds and Binding Commitments, Program Income, Reporting, Subrecipient Monitoring, and Special Tests and Provisions. Compliance with these requirements is the responsibility of the Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program’s management. Our responsibility is to express an opinion on the Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program’s compliance based on our audit.

### Compliance

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the *U.S. Environmental Protection Agency Audit Guide for Clean Water and Drinking Water State Revolving Fund Programs*. Those standards require that we plan and perform

the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on the Program occurred. An audit includes examining, on a test basis, evidence about the Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program’s compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program’s compliance with those requirements.

The Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program did not comply with the compliance requirements as described in the Comments Section of our report as Comment Number 2 (Subrecipient Monitoring) and Comment Number 3 (Federal Cash Transactions Report). Compliance with such requirements is necessary, in our opinion, for the Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program to comply with requirements applicable to the Federal program.

In our opinion, because of the effects of the noncompliance described in the preceding paragraph, the Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program did not comply, in all material respects, with the requirements referred to above that are applicable to the Program for the fiscal year ended June 30, 2004.

#### Internal Control Over Compliance

The management of the Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants. In planning and performing our audit, we considered the Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program’s internal control over compliance with requirements that could have a direct and material effect in order to determine our auditing procedures for the purpose of expressing an opinion on compliance and to test and report on the internal control over compliance.

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program’s ability to administer the Federal program in accordance with the applicable requirements of laws, regulations, contracts and grants. Reportable conditions are described in the Comments Section of the report as Comment Number 2 (Subrecipient Monitoring) and Comment Number 3 (Federal Cash Transactions Report).

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to the Federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their

assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions describe above, we consider Comment Number 2 (Subrecipient Monitoring) and Comment Number 3 (Federal Cash Transactions Report) to be material weaknesses. We also noted another matter involving internal control over compliance that we have reported to management of the Nebraska Department of Environmental Quality - Clean Water State Revolving Fund Program in a separate letter dated April 25, 2005.

This report is intended solely for the information and use of the Program, the federal awarding agencies, and citizens of the State of Nebraska, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

*Pat Reding, CPA*

Assistant Deputy Auditor

April 25, 2005