



OFFICE OF INSPECTOR GENERAL

*Catalyst for Improving the Environment*

## **Audit Report**

# **State of New Hampshire Clean Water State Revolving Fund Program Financial Statements for the Year Ended June 30, 2005**

**Report No. 2007-1-00037**

**February 7, 2007**

## **Abbreviations**

CAFR	Comprehensive Annual Financial Report
CWSRF	Clean Water State Revolving Fund
DES	New Hampshire Department of Environmental Services
EPA	U.S. Environmental Protection Agency
GASB	Government Accounting Standards Board
OIG	Office of Inspector General
OMB	Office of Management and Budget
SRF	State Revolving Fund



# At a Glance

*Catalyst for Improving the Environment*

## Why We Did This Audit

We performed this audit to determine:

- Whether the New Hampshire Clean Water State Revolving Fund Program's (the Program's) financial statements were fairly presented in all material respects,
- To what extent the Program's internal controls over financial reporting could be relied upon, and
- Whether the Program complied with applicable laws and regulations.

## Background

The requirement for audited financial statements was enacted to help ensure that the Program had management practices, systems, and controls in place to provide reliable information for managing the federally-funded program.

For further information, contact our Office of Congressional and Public Liaison at (202) 566-2391.

To view the full report, click on the following link:  
[www.epa.gov/oig/reports/2007/20070207-2007-1-00037.pdf](http://www.epa.gov/oig/reports/2007/20070207-2007-1-00037.pdf)

## **State of New Hampshire Clean Water State Revolving Fund Program Financial Statements for the Year Ended June 30, 2005**

### **What We Found**

We rendered an unqualified opinion on the New Hampshire Clean Water State Revolving Fund (CWSRF) Program financial statements for the year ended June 30, 2005.

We noted various reportable conditions that we considered material weaknesses in internal controls. These deficiencies in the design and operations of internal controls for the CWSRF-specific financial accounting and reporting could adversely affect the State's ability to record, process, and report financial data consistent with the assertions of management in the CWSRF financial statements. The State did not reconcile cash and investment balances to the CWSRF general ledger, and did not reconcile the general ledger to original source documentation, resulting in numerous unrecorded transactions and errors going undetected. The State made incorrect journal entries, incorrectly calculated amortization schedules, did not record loan payments, and materially misstated cash balances and short-term investments.

We qualified our opinion on compliance with applicable laws and regulations because the State did not comply with the subrecipient monitoring requirements for followup on subrecipient Single Audits.

### **What We Recommend**

To correct the internal controls weaknesses, we recommend that EPA require the New Hampshire Department of Environmental Services to: coordinate with the State Treasury to obtain up-to-date documentation on cash and investment transactions, make the necessary reconciliations, develop and implement procedures for reviewing and reporting, and develop training on the accounting system. For the compliance issue, we recommend that EPA require the State to implement a policy for Single Audit report review.



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY  
WASHINGTON, D.C. 20460

OFFICE OF  
INSPECTOR GENERAL

February 7, 2007

**MEMORANDUM**

SUBJECT: Auditor's Report for the State of New Hampshire  
Clean Water State Revolving Fund Program  
Financial Statements for the Year Ended June 30, 2005  
Report No. 2007-1-00037

TO: Robert W. Varney  
Regional Administrator, EPA Region 1

Attached is a copy of the subject audit we sent to the State of New Hampshire. The audit contains reports on the financial statements, internal controls, and compliance requirements applicable to the Clean Water State Revolving Fund program in New Hampshire for the year ended June 30, 2005. We issued an unqualified opinion on the financial statements and a qualified opinion on the compliance requirements, as discussed in our report on compliance. In our report on internal controls, we noted issues involving the internal control structure and its operations that we considered to be a material weakness.

This report represents the opinion of the Office of Inspector General and does not represent the final position of the U.S. Environmental Protection Agency (EPA). Final determination on matters in this report will be made by EPA managers in accordance with established audit resolution procedures.

The estimated cost of this report – calculated by multiplying the project's staff days by the applicable daily full cost billing rates in effect at the time – is \$106,798.

**Action Required**

In accordance with EPA Manual 2750, you are required to provide a written response to this report within 120 days. You should include a corrective actions plan for agreed upon actions, including milestone dates. Please email an electronic version of your response to [kasper.janet@epa.gov](mailto:kasper.janet@epa.gov).

We have no further objections to the further release of this report to the public. The report contains no confidential business or proprietary information. This report will be available at <http://www.epa.gov/oig>.

If you have any questions or concerns regarding this report, please contact Janet Kasper, the Director for Assistance Agreement Audits, at (312) 886-3059 or [kasper.janet@epa.gov](mailto:kasper.janet@epa.gov).

Sincerely,

A handwritten signature in black ink, appearing to read "Bill A. Roderick", written over a horizontal line.

Bill A. Roderick  
Acting Inspector General

Attachment

State of New Hampshire Clean Water State Revolving Fund Program  
Financial Statements for the Year Ended June 30, 2005

## ***Table of Contents***

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<b>Independent Auditor’s Report .....</b>	<b>1</b>
Statement of Net Assets.....	2
Statement of Revenues, Expenses, and Changes in Net Assets .....	3
Statement of Cash Flows .....	4
Notes to the Financial Statements .....	5
 <b>Independent Auditor’s 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> .....</b>	 <b>14</b>
Internal Control Findings, Recommendations, and Responses .....	17
Compliance Finding, Recommendation, and Response .....	20
 <b>Status of Recommendations and Potential Monetary Benefits.....</b>	 <b>22</b>
 <b>Distribution .....</b>	 <b>23</b>



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY  
WASHINGTON, D.C. 20460

OFFICE OF  
INSPECTOR GENERAL

## Independent Auditor's Report

We have audited the accompanying financial statements of the State of New Hampshire Clean Water State Revolving Fund Program (the Program) as of and for the year ended June 30, 2005. 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 that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements of the Program are intended to present the financial position, and the changes in financial position and cash flows of the Program. They do not purport to, and do not, present fairly the financial position of the State of New Hampshire, as of June 30, 2005, and the changes in its financial position and its cash flows, where applicable, for the year then ended 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 financial position of the Program, as of June 30, 2005, and the changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Office of Inspector General  
May 16, 2006

**State of New Hampshire  
Clean Water State Revolving Fund Program  
Statement of Net Assets  
as of June 30, 2005**

Assets	<u>SRF</u>	<u>Management</u>	<u>Total (Memorandum Only)</u>
Current assets:			
Cash and cash equivalents	\$ 58,078,559	\$ 2,119,655	\$ 60,198,214
Current receivables			
Loan interest	3,406,611		3,406,611
Investment interest	109,595		109,595
Due from other fund		90,722	90,722
Current portion of loans receivable			
Wastewater	11,262,567		11,262,567
Landfills	5,522,459		5,522,459
Re loans	<u>3,569,812</u>		<u>3,569,812</u>
Total current receivables	<u>23,871,044</u>	<u>90,722</u>	<u>23,871,044</u>
Total current assets	81,949,603	2,210,377	84,159,980
Noncurrent assets:			
Loans receivable, net of current portion			
Wastewater	93,533,584		93,533,584
Landfills	32,157,613		32,157,613
Re loans	<u>47,235,210</u>		<u>47,235,210</u>
Total noncurrent assets	<u>172,926,407</u>	<u>-</u>	<u>172,926,407</u>
Total assets	<u>254,876,010</u>	<u>2,210,377</u>	<u>257,086,387</u>
Liabilities and Net Assets			
Current liabilities			
Due to other funds	176,007	809	176,816
Project costs payable	<u>608,978</u>		<u>608,978</u>
Total liabilities	784,985	809	785,794
Net assets:			
Restricted	<u>254,091,025</u>	<u>2,209,568</u>	<u>256,300,593</u>
Total liabilities and net assets	<u>\$ 254,876,010</u>	<u>\$ 2,210,377</u>	<u>\$ 257,086,387</u>

See accompanying notes to the financial statements.



**State of New Hampshire  
Clean Water State Revolving Fund Program  
Statement of Revenues, Expenses, and Changes in Net Assets  
for the Year Ended June 30, 2005**

	<u>SRF</u>	<u>Management</u>	<u>Total (Memorandum Only)</u>
Operating revenues			
Loan interest	\$ 4,356,317		\$ 4,356,317
Investment earnings	1,230,524		1,230,524
Management fees		<u>\$ 1,646,071</u>	<u>1,646,071</u>
Total operating revenues	<u>5,586,841</u>	<u>1,646,071</u>	<u>7,232,912</u>
Operating expenses			
Administrative costs	<u>737,562</u>	<u>1,489,642</u>	<u>2,227,204</u>
Operating income	<u>4,849,279</u>	<u>156,429</u>	<u>5,005,708</u>
Capital contributions			
Federal grants	12,756,503		12,756,503
State contributions	<u>2,551,296</u>		<u>2,551,296</u>
Total capital contributions	<u>15,307,799</u>		<u>15,307,799</u>
Change in net assets	20,157,078	156,429	20,313,507
Net assets, beginning of year	<u>233,933,947</u>	<u>2,053,139</u>	<u>235,987,086</u>
Net assets, end of year	<u>\$ 254,091,025</u>	<u>\$ 2,209,568</u>	<u>\$ 256,300,593</u>

See accompanying notes to the financial statements.

**New Hampshire Department of Environmental Resources  
Clean Water State Revolving Fund  
Statement of Cash Flows  
for the Year Ended June 30, 2005**

Cash flows from operating activities:	
Principal repayments received from borrowers	\$ 15,305,197
Interest payments received from borrowers	4,692,417
Loan advances to borrowers	(25,008,637)
Management fees	1,646,071
Interest on investments	1,125,000
Payments to suppliers and employees	(2,185,069)
Net payments to other funds	<u>(4,932)</u>
Cash (used) by operating activities	(4,429,953)
Cash flows from capital and related financing activities:	
Environmental Protection Agency	12,756,503
State of New Hampshire	<u>2,551,296</u>
Net cash from (used in) capital and related financing activities	<u>15,307,799</u>
Net cash provided by operating activities	10,877,846
Cash and cash equivalents, beginning of year	49,320,368
Cash and cash equivalents, end of year	<u><u>60,198,214</u></u>
Reconciliation of operating income to cash (used) by operating activities	
Operating income	\$ 5,005,708
Adjustments to reconcile operating income to net cash flow (used) by operating activities:	
(Increase) decrease in current receivables	150,891
Increase (decrease) in current liabilities	116,888
Disbursements on loans	(25,008,637)
Loan principal repayments	15,305,197
Net cash (used) by operating activities	<u><u>\$ (4,429,953)</u></u>

**New Hampshire Department of Environmental Resources  
Clean Water State Revolving Fund**

**Notes to the Financial Statements**

**1. Organization of the Fund**

The New Hampshire Clean Water State Revolving Fund Program (the Program) was established pursuant to Title VI of the Federal Water Quality Act of 1987 (the Act). The Act established the State Revolving Fund (SRF) program to replace the construction grants program. The purpose of the SRF is to provide low interest loans to local governments for the purpose of constructing wastewater treatment facilities, implementing nonpoint source management plans and estuary management plans. The loan repayment period ranges from five to twenty years, and all repayments, including interest and principal, must be credited to the Program.

The SRF program is administered by the State of New Hampshire's Department of Environmental Services (DES), and consists of a loan fund (SRF) to record loan and related activity and an administrative fund (Management) that collects fees and pays some of the operating costs of the program, and are collectively referred to as the Program. The Department's primary responsibilities for the SRF include obtaining capitalization grants from the Environmental Protection Agency (EPA), soliciting potential interested parties for loans, negotiating loan agreements with local communities, reviewing and approving payment requests from loan recipients, monitoring the loan repayments, and conducting inspection and engineering reviews to ensure compliance with all applicable laws, regulations, and program requirements.

The program does not have any full time employees, instead, the DES charges the Program for time spent on SRF activities by its employees and the Program reimburses DES for such costs the following month. The charges include the salaries and benefits of employees, as well as indirect costs allocated to the program. Employees are covered by the benefits available to State of New Hampshire employees.

The Program's financial statements, footnotes, and related schedules are presented for the U.S. Environmental Protection Agency. The Program is included in the State of New Hampshire's comprehensive annual financial report (CAFR) as part of the governmental fund financial statements, which use the modified accrual basis of accounting. Due to differences in reporting methods, there may be differences between the amounts reported in these financial statements and the States CAFR.

**2. Summary of Significant Accounting Policies**

***Basis of Accounting***

The financial statements for the Program are presented as an enterprise fund. As such, the Program is accounted for using the flow of economic resources measurement focus

**New Hampshire Department of Environmental Resources  
Clean Water State Revolving Fund**

**Notes to the Financial Statements**

**2. Summary of Significant Accounting Policies (continued)**

and is maintained on the accrual method of accounting, revenues are recognized when earned and expenses are recorded at the time the liabilities are incurred. All assets and liabilities associated with the operations of the Program are included on the balance sheet. The State has elected to follow the accounting pronouncements of the Governmental Accounting Standards Board (GASB), as well as statements issued by the Financial Accounting Standards Board (FASB) on or before November 30, 1989, unless the pronouncements conflict with or contradict GASB pronouncements.

***Cash and Cash Equivalents***

All monies of the Program are deposited with the New Hampshire State Treasurer Department which is responsible for maintaining these deposits in accordance with New Hampshire State law. The Program considers all such deposits to be cash. The Program, on a monthly basis, receives investment interest earnings on these deposits. According to State law, the Treasurer is responsible for maintaining the cash balances and investing excess cash of the Program, as further discussed in Note 3. Consequently, management of the Program does not have any control over the investment of the excess cash. The statement of cash flows considers all funds deposited with the Treasurer to be cash or cash equivalents.

***Loans Receivable***

Loans are funded by capitalization grants from EPA, State matching funds, funds generated from repayments and fund earnings. Loan funds are advanced to local agencies on a cost reimbursement basis, and interest begins accruing when funds are disbursed. After construction is completed, the local agency can elect to add the construction period interest to the loan amount, or they can pay it in total with the first loan repayment. Loans are amortized over periods of five, ten, fifteen or twenty years, and repayment of the loans must begin within one year of construction completion. There is no provision for uncollectible accounts, as all repayments are current, and management believes all loans will be repaid according to the loan terms.

***Contributed Capital***

In accordance with generally accepted accounting principles (GAAP), funds received from EPA and the State of New Hampshire for the capitalization of the Program are reported in the statement of revenues, expenses, and changes in fund net assets after nonoperating revenues and expenses.

**New Hampshire Department of Environmental Resources  
Clean Water State Revolving Fund**

**Notes to the Financial Statements**

**3. Cash, Cash Equivalents, and Investments**

GASB Statement 40, Deposit and Investment Risk Disclosures-an amendment of GASB Statement No. 3, was implemented for the fiscal year ended June 30, 2005. As a result, the disclosures related to deposit and investment risks were changed.

**Deposits:**

The following statutory requirements and Treasury Department policies have been adopted to minimize risk associated with deposits:

New Hampshire statute RSA 6:7 established policies the state Treasurer must adhere to when depositing public monies. Operating funds are invested per investment policies that further define appropriate investment choices and constraints as they apply to those investment types.

**Custodial Credit Risk:** The custodial risk for deposits is the risk that in the event of a bank failure, the state's deposits may not be recovered.

Custodial credit risk is managed in a variety of ways. Although State law does not require deposits to be collateralized, the Treasurer does utilize such arrangements where prudent and/or cost effective. All banks where the State has deposits and/or active accounts are monitored as to their financial health through the services of Veribanc, Inc., a bank rating firm. In addition, ongoing reviews with officials of depository institutions are used to allow for frequent monitoring of custodial credit risk.

All depositories used by the state must be approved at least annually by the Governor and Executive Council. All commercial paper must be from issuers having an A1/P1 rating or better and an AA- or better long-term debt rating from one or more of the nationally recognized rating agencies. Certificates of deposits must be with state or federally chartered banking institutions with a branch in New Hampshire. The institution must have the highest rating as measured by Veribanc, Inc.

Whereas all payments made to the State are to be in U.S dollars, foreign currency risk is essentially nonexistent on State deposits.

As of June 30, 2005, the CWSRF's bank balances were exposed to custodial credit risk as follows:

**New Hampshire Department of Environmental Resources  
Clean Water State Revolving Fund**

**Notes to the Financial Statements**

**3. Cash, Cash Equivalents, and Investments (continued)**

CWSRF Fund Deposit Credit Risk  
June 30, 2005 (amounts in thousands)

Type	Insured	Collateralized & Held in State's Name	Uncollateralized
Demand Deposit	\$228,685		\$0
Money Market	35,335,332		0
Overnight Repurchase Agreements			
Term Repurchase Agreements	12,420,625	10,093,917	
Totals	<u>\$47,984,642</u>	<u>\$10,093,917</u>	<u>\$0</u>

**Investments:**

The Treasury Department has adopted policies to ensure reasonable rates of return on investments while minimizing risk factors. Approved investments are defined in New Hampshire statutes. Additionally, investment guidelines exist for operating funds as well as trust and custodial funds. All investments are denominated in U.S. dollars. As of June 30, 2005, the CWSRF had the following types of investments:

Investment Type	Balance
Term Repurchase Agreements	\$10,093,917
Money Markets	35,335,332
Total Investments	<u>\$45,429,249</u>

The table below reconciles the cash and investments in the financial statements to the footnote.

Per Balance Sheet	
Cash and Cash Equivalents	<u>\$60,198,214</u>
Per Footnote	
Carrying amount of deposits	14,768,965
Investments	45,429,249
Total per footnote	<u>\$60,198,214</u>

**New Hampshire Department of Environmental Resources  
Clean Water State Revolving Fund**

**Notes to the Financial Statements**

**4. Loans Receivable**

The Program makes loans to qualified local agencies at interest rates ranging from .1575 percent to 4.128 percent. Interest rates are initially set in the original loan agreement, and then when the project is completed a supplemental loan agreement fixes the final interest rate to be charged at the lower of the original loan agreement or prevailing market rate, according to the following formula:

<u>Loan Term</u>	<u>Interest Rate</u>
5 years	25% of market minus 1%
10 years	50% of market minus 1%
15 years	75% of market minus 1%
20 years	80% of market minus 1%

Details of loans receivable as of June 30, 2005 are as follows:

<u>Original Loan Commitments</u>	<u>Outstanding Balance 6/30/04</u>	<u>Disbursements</u>	<u>Repayments</u>	<u>Outstanding Balance 6/30/05</u>
\$388,259,707	\$ 182,968,828	\$ 25,617,614	\$15,305,197	\$193,281,245

Loans mature at various intervals through January 1, 2026. The scheduled principal repayments for completely disbursed loans in subsequent years are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2006	\$ 18,049,563	\$ 3,548,958	\$ 21,598,521
2007	12,404,642	3,353,985	15,758,627
2008	11,345,737	3,045,437	14,391,174
2009	9,733,179	2,775,432	12,508,611
2010	9,339,384	2,531,323	11,870,707
2011 - 2015	41,003,641	8,883,622	49,887,263
2016 - 2020	26,697,461	3,648,844	30,346,305
2021 - 2025	9,360,883	547,622	9,908,505
2026	14,860	1,747	16,607
Totals	<u>\$ 137,949,350</u>	<u>\$ 28,336,970</u>	<u>\$ 166,286,320</u>

**New Hampshire Department of Environmental Resources  
Clean Water State Revolving Fund**

**Notes to the Financial Statements**

**4. Loans Receivable (continued)**

DES has three categories of loans receivable, wastewater, landfills and repayments. The wastewater loans are for sewer and wastewater treatment projects. The landfill loans provide financial assistance for municipalities to close unlined landfills as well as the construction of transfer stations and recycling facilities directly related to the specific landfill closure projects. The repayment loans are loans made from revolving funds for either wastewater or landfill closure loans. The balances of these loan categories as of June 30, 2005 are as follows:

Wastewater projects	\$ 104,796,151
Landfill projects	37,680,071
Repayment projects (revolving loans)	<u>50,805,023</u>
	<u>\$ 193,281,245</u>

**5. Contributed Capital**

The Program is capitalized by annual grants through the EPA. The State of New Hampshire must also contribute an amount equal to 20 percent of the federal capitalization amount. New Hampshire's matching contribution has been provided through the appropriation of State resources. As of June 30, 2005, EPA has awarded capitalization grants of \$226,232,978 to the State, of which \$185,356,820 has been drawn for loans and administrative expenses. The State has provided match funds of \$45,254,595, of which \$37,071,359 has been deposited into the SRF.

The following table summarizes the capitalization grant award, amounts drawn on each grant as of the balance sheet date, and balances available for future loans and administrative expenses.



**New Hampshire Department of Environmental Resources  
Clean Water State Revolving Fund**

**Notes to the Financial Statements**

**5. Contributed Capital (continued)**

	<u>Grant Amt</u>	<u>Draws 6/30/04</u>	<u>2005 Draws</u>	<u>Draws 6/30/05</u>	<u>Available 6/30/05</u>
1991	\$ 40,690,941	\$ 40,690,941		\$ 40,690,941	-
1992	19,417,068	19,417,068		19,417,068	-
1993	19,207,782	19,207,782		19,207,782	-
1994	11,918,313	11,918,313		11,918,313	-
1995	12,834,171	12,834,171		12,834,171	-
1996	20,162,543	20,162,543		20,162,543	-
1997	6,191,100	6,191,100		6,191,100	-
1998	15,456,773	15,456,773		15,456,773	-
1999	13,698,723	13,698,723		13,698,723	-
2000	13,412,223	13,022,903	\$ 389,320	13,412,223	-
2001	13,293,027		12,367,183	12,367,183	\$ 925,844
2002	13,322,628				13,322,628
2003	13,423,664				13,423,664
2004	13,204,022				13,204,022
	<u>\$ 226,232,978</u>	<u>\$ 172,600,317</u>	<u>\$ 2,756,503</u>	<u>\$ 185,356,820</u>	<u>\$ 40,876,158</u>

As of June 30, 2004 and 2005, State matching contributions were as follows:

	<u>Total Match As of June 30, 2004</u>	<u>2005 Contribution</u>	<u>Total Match As of June 30, 2005</u>
New Hampshire State Matching Contribution	\$ 34,520,063	\$ 2,551,296	\$ 37,071,359

**New Hampshire Department of Environmental Resources  
Clean Water State Revolving Fund**

**Notes to the Financial Statements**

**6. Administrative Costs and Management Fee Revenue**

The Clean Water Act provides for states to use up to four percent of the capitalization grants toward SRF program administrative costs. The program also charges local agencies a one percent annual management fee on the outstanding principal balance after August 1996. These fees are deposited in a fund (Management) outside the SRF and are to be used to pay for the administrative costs of the Clean Water Revolving Loan Program as well as related water quality control costs.

Total management fees and expenses as of June 30, 2005 are shown in the table following:

<u>Fiscal Year</u>	<u>Fees Earned</u>	<u>Expenditures</u>
1997	\$227,395	\$138,619
1998	523,836	277,972
1999	570,120	324,457
2000	658,775	430,811
2001	838,128	396,318
2002	1,225,115	815,187
2003	1,323,794	932,450
2004	1,312,001	1,311,604
2005	1,646,071	1,489,642
Totals	<u>\$8,325,235</u>	<u>\$6,117,060</u>

Total administrative costs charged to the Program are as follows:

Fiscal Year	SRF Administrative Costs	Management Administrative Cost	Total Administrative Costs
1997	\$ 423,393	\$ 138,619	\$ 562,012
1998	430,684	277,972	708,656
1999	448,855	324,457	773,312
2000	530,344	430,811	961,155
2001	566,000	396,318	962,318
2002	608,674	815,187	1,423,861
2003	682,187	932,450	1,614,637
2004	704,101	1,311,604	2,015,705
2005	737,562	1,489,642	2,227,204
Totals	<u>\$ 5,131,800</u>	<u>\$ 6,117,060</u>	<u>\$ 11,248,860</u>

**New Hampshire Department of Environmental Resources  
Clean Water State Revolving Fund**

**Notes to the Financial Statements**

**7. Contingencies, Related Parties, and Subsequent Events**

**Contingencies**

The Program is exposed to various risks of loss related to torts, thefts of assets, errors or omissions, injuries to state employees while performing Program business, or acts of God. The State maintains insurance for all risks of loss, which is included in the indirect costs allocated to the Program.

According to DES management and legal counsel, there are no other loss contingencies, which require disclosure or accrual under the Statement of Financial Accounting Standards No. 5.

**Related Parties**

There are no related party transactions with or related amounts receivable from management of the Program.

**Independent Auditor's 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***



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY  
WASHINGTON, D.C. 20460

OFFICE OF  
INSPECTOR GENERAL

We have audited the financial statements of the New Hampshire Clean Water State Revolving Fund Program (the Program) as of and for the year ended June 30, 2005, and have issued our report thereon dated May 16, 2006. 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 Program's and the Division of Environmental Protection's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the Program's financial statements and not to provide an opinion on the internal control over the Program's financial reporting. However, we noted certain matters involving the internal control over financial reporting 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 financial reporting that, in our judgment, could adversely affect the Program's ability to record, process, summarize, and report financial data consistent with the assertions of management in the Program's financial statements. Reportable conditions are described in the accompanying schedule of findings and responses.

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 consider the reportable conditions described in the accompanying schedule of findings, recommendations, and responses to be material weaknesses.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Program's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a

direct and material effect on the determination of financial statement amounts. This included tests of specific program requirements governing allowability for specific activities, allowable costs, cash management, State matching, period of availability of funds and binding commitments, program income, reporting, and subrecipient monitoring that are applicable to the Program for the year ended June 30, 2005.

The management of the Program is responsible for the Program's compliance with those requirements. Our responsibility is to express an opinion on those requirements based on our audit. An audit includes examining, on a test basis, evidence about the Program's compliance with those requirements. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, except for the matter noted in the finding and recommendation section that follows, the Program complied, in all material respects, with the specific program requirements that are applicable to the Program for the year ended June 30, 2005.

This report is intended solely for the information and use of management of the Program and the U.S. Environmental Protection Agency, and is not intended to be and should not be used by anyone other than these specified parties.

Office of Inspector General  
May 16, 2006

## Internal Control Findings, Recommendations, and Responses

Pursuant to American Institute of Certified Public Accountants standards incorporated by Generally Accepted Government Auditing Standards as described in the accompanying *Independent Auditor's 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*, relating to New Hampshire's Clean Water State Revolving Fund (CWSRF) program, the following reportable conditions are considered as material weaknesses. We have discussed these matters with appropriate State officials.

### Control Environment Needs Improvement

The foundation of the accounting and reporting system is the control environment established by management. Management sets the tone of the organization, and determines the accounting systems and procedures to be used. Management also establishes the necessary controls and policies to assure that the assertions inherent in an accounting system are followed.

Management assertions include:

- **Existence or occurrence:** The assets and liabilities of the organization exist at a given date, and recorded transactions occurred during the proper period.
- **Completeness:** All transactions and accounts that should be included are included in the accounting system.
- **Valuation or allocation:** The accounts are recorded and presented at appropriate amounts.

The CWSRF is accounted for and reported within the Department of Environmental Services' (DES) General Fund. In order to facilitate program reporting required by the U.S. Environmental Protection Agency (EPA), DES maintains a separate CWSRF accounting system and provides EPA with program-specific financial statements. We noted deficiencies in the design and operations of DES' internal controls for the CWSRF-specific financial accounting and reporting that, in our judgment, could adversely affect DES' ability to record, process, and report financial data consistent with the assertions of management in the CWSRF financial statements. These conditions appear to have resulted, in part, from (1) the use of a separate spreadsheet-based accounting system that a limited number of employees and management are familiar with; (2) a lack of adequate training on the CWSRF-specific accounting system; (3) inadequate written procedures for key areas such as monthly reconciliations to the CWSRF general ledger and CWSRF financial reporting; (4) lack of management understanding, review and approval of entries to the CWSRF general ledger and supporting schedules; and (5) significant turnover of key staff and management working in the CWSRF program over the last 2 years. Specifically, we noted the following matters that impact management assertions:

***Existence or Occurrence:*** Periodic reconciliations of the CWSRF general ledger to the actual cash and investment accounts maintained by the Treasurer is an important control aspect that can provide assurances that the accounting records properly record cash and investment transactions and balances. Management review of these reconciliations provides assurances that these controls are working as intended.

We found that DES was reviewing the “zero balance” (the account used to deposit Federal draws and related State match, and subsequent disbursements for loans or administration) and “repayment” (the account for loan repayments and subsequent disbursement for loans) accounts and noting any discrepancies. However, DES was not actually posting adjustments for discrepancies to cash and investment balances in the CWSRF general ledger.

As a result of inadequate procedures for reconciling cash and investment balances on the CWSRF general ledger to the cash and investments maintained by the Treasury, the cash balance was understated and the investment balance in the CWSRF general ledger was overstated at June 30, 2005 by approximately \$5,700,000 and \$5,000,000, respectively. The net difference was primarily due to investment earnings that had been deposited to the accounts but were not recognized as received on the CWSRF general ledger.

***Completeness:*** As a result of the inadequate reconciliation procedures noted above, a long-term repurchase agreement and its related \$202,580 in investment earnings had not been recognized on the CWSRF general ledger.

***Valuation or Allocation:*** The amounts recorded in the CWSRF general ledger for loans and related interest receivable should be supported by subsidiary schedules that provide details by specific loans. Loans included on the schedule should be supported by proper loan documentation (such as loan agreements, requests for disbursements, and loan amortization schedules). The subsidiary schedules should be periodically reconciled to the CWSRF general ledger.

The State did not reconcile loan receivable balances to the CWSRF general ledger properly. While the reconciliations identified specific loans that required adjustment, no adjustments were posted to the general ledger. As a result, loans receivable at June 30, 2004, were approximately \$19,000 greater than the supporting loan schedules, and interest receivable balances were misstated by approximately \$132,000 and \$103,000 at June 30, 2004 and 2005, respectively. Loan interest earnings for 2005 were misstated by approximately \$29,000. To ensure that general ledger balances are supported by subsidiary records, management should review the supporting schedules on a regular basis to ensure the necessary adjustments have been made and the schedules support the CWSRF general ledger balances.

## **Summary**

SRF management has the responsibility to establish and maintain an accounting system and control environment that both encourages and requires accurate financial information and reporting. Management needs to ensure that the controls, policies, and accounting system are designed and operating properly by reviewing monthly reports, reconciliations, and financial statements, and making inquiries of staff. Prior to our audit, DES had recognized the need to



improve its CWSRF-specific accounting and management system. DES is currently in the process of developing a new system expected to address this condition.

## **Recommendations**

We recommend that the EPA Regional Administrator, Region 1, require the DES to:

1. Coordinate with the Treasury and obtain up-to-date documentation on specific cash and investment transactions and balances. A schedule of cash, investments, and related earnings per the Treasurer should be reconciled with supporting documents and the CWSRF general ledger on a recurring basis.
2. Reconcile its subsidiary schedule(s) for loans and interest receivable with the CWSRF general ledger on a recurring basis.
3. Develop and implement procedures for appropriate review and approval of accounting entries and reporting from the CWSRF-specific accounting system, including year-end closing and reporting.
4. Develop training on the CWSRF-specific accounting system for all appropriate staff and management, including the accountants, the accounting manager, and program manager.

## **State Response**

The State responded on November 22, 2006, with the following:

*With regards to the comments on the accounting system, DES is in the middle of a system conversion from our manual, Excel spreadsheet based, system to a general ledger system. When this system conversion is complete, the majority of the posting and reconciliation issues will be resolved as we will have one integrated accounting package.*

*Concerning the issue with Treasury, we are working with that department to improve the timely receipt of bank statements from them in order for DES to perform our reconciliations and postings in a timely manner.*

*Procedures have been developed for review and approval of accounting entries and for the reconciliation of subsidiary schedules to the general ledger.*

*As to training, all users will be trained on the new system and user guides will be developed for each level of user.*

## **OIG Response**

We find the State's response to be acceptable.

## Compliance Finding, Recommendation, and Response

### Noncompliance on Subrecipient Monitoring

Office of Management and Budget (OMB) Circular A-133 and EPA regulations at Title 40, Code of Federal Regulations, Section 31.26 require that a pass-through entity ensure that subrecipients expending \$500,000 or more in Federal awards during the subrecipient's fiscal year meet the Single Audit requirements for that fiscal year. The pass-through entity is to issue a management decision on any audit findings within 6 months after receipt of the subrecipient's audit report and ensure that the subrecipient takes appropriate and timely corrective action. (OMB Circular A-133, Subpart D §\_\_.400(d))

DES did not have procedures in place to ensure that borrowers expending Federal awards met the Single Audit requirements to issue management decisions with 6 months of receipt of the audit reports, or to ensure that subrecipients take appropriate and timely corrective action. The Program management was not aware that the monitoring of and response to Single Audit requirements was necessary.

DES was not aware of the Single Audit status of their borrowers and therefore were not aware if the borrower's audit had uncovered any issues of noncompliance.

### Recommendation

We recommend that the EPA Regional Administrator, Region 1, require the DES to:

5. Implement a Single Audit report review and corrective action policy consistent with OMB Circular A-133 and EPA regulations.

### States Response

The State responded on November 22, 2006, with the following:

*In compliance with the March 6, 2000 recommendation from Charles R. McCollum, Audit Manager at OIG, regarding sub-recipient monitoring, on April 17, 2000 DES submitted the policy to EPA, Region 1 for review and approval. By letter dated February 2, 2001, EPA responded that, after review of the policy by the regional office and the OIG, "we consider these steps to be prudent and we find that your policy complies with the sub-recipient monitoring requirements."*

*Based on this approved policy, DES believes that the CWSRF Program is in compliance with sub-recipient monitoring requirements. However, it appears that the OIG recommendation to EPA Region 1 in the current draft audit report would further require DES to "implement a Single Audit report review and corrective action policy consistent with OMB Circular A-133 and EPA regulations." DES agrees to work with EPA, Region 1 in amending the present policy to meet these requirements if requested to do so.*

**OIG Response**

EPA Region 1 should work with the State to assure that it meets the requirements of OMB Circular A-133 and Title 40, Code of Federal Regulations, Section 31.26, regarding pass-through entity responsibilities for followup on subrecipient audits.

## **Status of Recommendations and Potential Monetary Benefits**

RECOMMENDATIONS						POTENTIAL MONETARY BENEFITS (in \$000s)	
Rec. No.	Page No.	Subject	Status <sup>1</sup>	Action Official	Planned Completion Date	Claimed Amount	Agreed To Amount
1	19	Require DES to coordinate with the Treasury and obtain up-to-date documentation on specific cash and investment transactions and balances. A schedule of cash, investments, and related earnings per the Treasurer should be reconciled with supporting documents and the CWSRF general ledger on a recurring basis.	O	EPA Regional Administrator, Region 1			
2	19	Require DES to reconcile its subsidiary schedule(s) for loans and interest receivable with the CWSRF general ledger on a recurring basis.	O	EPA Regional Administrator, Region 1			
3	19	Require DES to develop and implement procedures for appropriate review and approval of accounting entries and reporting from the CWSRF-specific accounting system, including year-end closing and reporting.	O	EPA Regional Administrator, Region 1			
4	19	Require DES to develop training on the CWSRF-specific accounting system for all appropriate staff and management, including the accountants, the accounting manager, and program manager.	O	EPA Regional Administrator, Region 1			
5	20	Require DES to implement a Single Audit report review and corrective action policy consistent with OMB Circular A-133 and EPA regulations.	O	EPA Regional Administrator, Region 1			

<sup>1</sup> O = recommendation is open with agreed-to corrective actions pending  
 C = recommendation is closed with all agreed-to actions completed  
 U = recommendation is undecided with resolution efforts in progress

## **Distribution**

### **EPA Region 1**

Regional Administrator  
Director of Office of Ecosystem Protection  
Manager of Municipal Assistance Unit  
Audit Liaison  
CWSRF Coordinator

### **EPA Headquarters**

Director, Grants Administration Division  
Agency Followup Coordinator  
Infrastructure Branch Chief  
CWSRF Coordinator  
CWSRF Audit Manager

### **New Hampshire Department of Environmental Services**

Commissioner  
Chief Operating Officer  
CWSRF Supervisor