



OFFICE OF INSPECTOR GENERAL

*Catalyst for Improving the Environment*

## **Audit Report**

# **State of Oregon Safe Drinking Water Revolving Loan Fund**

**Financial Statements with  
Independent Auditor's Report, June 30, 2004**

**Report No. 2005-1-00157**

**September 12, 2005**

## **Abbreviations**

CFR            Code of Federal Regulations

EPA            United States Environmental Protection Agency

OECCDD       Oregon Economic and Community Development Department



# At a Glance

*Catalyst for Improving the Environment*

## Why We Did This Review

We performed this audit to determine:

- If the Oregon Safe Drinking Water Revolving Loan Fund's financial statements were fairly presented in all material respects;
- To what extent the Oregon Safe Drinking Water Revolving Loan Fund's internal controls over financial reporting could be relied upon; and
- Whether the Oregon Safe Drinking Water Revolving Loan Fund complied with applicable laws and regulations.

## Background

The requirement for audited financial statements was enacted to help ensure that State Revolving Fund programs 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/2005/20050912-2005-1-00157.pdf](http://www.epa.gov/oig/reports/2005/20050912-2005-1-00157.pdf)

## **State of Oregon Safe Drinking Water Revolving Loan Fund Fiscal 2004 Financial Statements**

### **Oregon Safe Drinking Water Revolving Loan Fund Receives Qualified Opinion**

We issued a qualified opinion on the financial statements of Oregon's Safe Drinking Water Revolving Loan Fund for the fiscal year ended June 30, 2004. We also qualified our opinion on compliance with applicable laws and regulations, and noted a material weakness in internal controls, discussed in the following sections.

### **Internal Control Weakness Noted**

The State accounting system does not document and support the assets, liabilities, net assets, and revenues and expenditures of the Set-Aside fund in accordance with Generally Accepted Accounting Principles. Further, the information provided during the audit does not agree with the information provided in the financial statements.

### **Noncompliance with Laws and Regulations Noted**

We noted the following noncompliance with laws and regulations:

- The State of Oregon accounting system does not track revenues and expenditures for the set-aside programs on a fiscal year basis. The Safe Drinking Water Act requires that States account for all activities in accordance with Generally Accepted Accounting Principles.
- The program performed technical and managerial evaluations that identified deficiencies that were not made conditions of the loan agreement as required by regulation. The program provided a list of corrective actions that should be sufficient to correct the problem.



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY  
WASHINGTON, D.C.

OFFICE OF  
INSPECTOR GENERAL

September 12, 2005

**MEMORANDUM**

SUBJECT: Auditor's Report for the State of Oregon Safe Drinking Water  
Revolving Loan Fund as of June 30, 2004  
Report No. 2005-1-00157

FROM: *Leah L. Nikaidoh, Acting Director for*  
Michael A. Rickey  
Director, Assistance Agreement Audits

TO: Michael Bogert  
Regional Administrator  
EPA Region 10

Attached is a copy of the subject audit we sent to the State of Oregon. The audit contains reports on the financial statements, internal controls, and compliance requirements applicable to the Drinking Water State Revolving Fund Program in Oregon for the year ended June 30, 2004.

We have issued a qualified 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 an issue involving the internal control structure and its operations that we considered to be a material weakness.

In accordance with EPA Directive 2750, the Action Official is required to take action on the findings and recommendations in this report within 150 days.

The Office of Inspector General has no objection to the release of this report to any member of the public upon request. The report contains no confidential business or proprietary information.

If you have any questions or concerns, please contact Mr. William Dayton at (916) 498-6590 or Mr. Darren Schorer at (206) 553-6288.

Attachment

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## At a Glance

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UNITED STATES ENVIRONMENTAL PROTECTION AGENCY  
WASHINGTON, D.C.

OFFICE OF  
INSPECTOR GENERAL

**Independent Auditor's Report on  
Oregon Safe Drinking Water Revolving Loan Fund Program  
Fiscal 2004 Financial Statements**

We have audited the accompanying Statement of Net Assets of the Oregon Safe Drinking Water Revolving Loan Fund Program (the Program) as of June 30, 2004, and the related Statements of Revenues, Expenses, and Changes in Net Assets, and Statement of Cash Flows for the year then ended. These financial statements are the responsibility of the Program management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards in the United States of America and *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.

The Program was unable to document and support the assets, liabilities, net assets, and revenues and expenditures of the Set-Aside Funds in accordance with Generally Accepted Accounting Principles. The State of Oregon accounting system does not track revenues and expenditures on a fiscal year basis for grant type programs, and we were not able to apply other auditing procedures to satisfy ourselves as to opening balances and current year activity. Accordingly, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the Set-Aside Fund or its results of operations for the year ended June 30, 2004.

In our opinion, except for the effect of the issues discussed in the preceding paragraph, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Oregon Safe Drinking Water Revolving Loan Fund and the results of its operation and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1, the financial statements referred to above are intended to present the financial position and results of operations of the Oregon Safe Drinking Water Revolving Loan Fund, a component fund of the State of Oregon. These statements are not intended to present the financial position or results of operations for the State of Oregon, the Oregon Department of Human Services, or the Oregon of Economic and Community Development Department, in

conformity with accounting principles generally accepted in the United States, of which the Safe Drinking Water Revolving Loan Fund is a part.

In accordance with *Government Auditing Standards*, we have also issued a report, dated February 9, 2005, on our consideration of the Oregon Safe Drinking Water Revolving Loan Fund's internal control structure and a report dated February 9, 2005, on its compliance with laws and regulations. Those reports are integral parts of an audit prepared in accordance with auditing standards generally accepted in the United States of America and should be read in conjunction with the report in considering the results of our audit.

Office of Inspector General  
Environmental Protection Agency

February 9, 2005

**STATE OF OREGON**  
**Safe Drinking Water Revolving Loan Fund**  
**Statement of Net Assets**  
**June 30, 2004**

<u>Assets</u>	<u>Loans</u>	<u>Set Asides (Unaudited)</u>	<u>Total</u>
Current assets:			
Cash and cash equivalents	\$ 12,993,330	\$ 5	\$ 12,993,335
Receivables:			
Current maturities of loans	1,676,318		1,676,318
Interest receivable	805,057		805,057
Accounts receivable-Federal		333,370	333,370
Due from other agencies	<u>56,660</u>	<u>62,938</u>	<u>119,598</u>
Total current assets	<u>15,531,365</u>	<u>396,313</u>	<u>15,927,678</u>
Noncurrent assets			
Loans receivable, net	<u>50,016,891</u>		<u>50,016,891</u>
Total assets	<u>65,548,256</u>	<u>396,313</u>	<u>65,944,569</u>
 <b><u>Liabilities and Net Assets</u></b>			
Liabilities:			
Current liabilities:			
Accrued liabilities/ accounts payable	<u>25,694</u>	<u>214,282</u>	<u>239,976</u>
Total current liabilities	<u>25,694</u>	<u>214,282</u>	<u>239,976</u>
Noncurrent liabilities			
Due to other funds	100,000	62,422	162,422
Due to other agencies		<u>116,622</u>	<u>116,622</u>
Total noncurrent liabilities	<u>100,000</u>	<u>179,044</u>	<u>279,044</u>
Total liabilities	<u>125,694</u>	<u>393,326</u>	<u>519,020</u>
Net assets:			
Restricted	<u>65,422,562</u>	<u>2,987</u>	<u>65,425,549</u>
Total liabilities and net assets	<u>\$ 65,548,256</u>	<u>\$ 396,313</u>	<u>\$ 65,944,569</u>



**STATE OF OREGON**  
**Safe Drinking Water Revolving Loan Fund**  
**Statement of Revenues, Expenses, and Changes in Net Assets**  
**For the year ended June 30, 2004**

	<u>Loans</u>	<u>Set Asides (Unaudited)</u>	<u>Total</u>
<b>Operating Revenues:</b>			
Interest income on SRF loans	\$ 1,158,539		\$ 1,158,539
Federal receipts	<u>301,653</u>	<u>13,058,257</u>	<u>13,359,910</u>
Total operating revenue	<u>1,460,192</u>	<u>13,058,257</u>	<u>14,518,449</u>
<b>Operating Expenses:</b>			
Personal services	255,241	618,222	873,463
Services and supplies	24,245	978,666	1,002,911
Loan principal forgiven	1,466,814		1,466,814
Expenditures		328,974	328,974
Financial statement accruals		<u>5,942</u>	<u>5,942</u>
Total operating expenses	<u>1,746,300</u>	<u>1,931,804</u>	<u>3,678,104</u>
<b>Operating income (loss)</b>	(286,108)	11,126,453	10,840,345
<b>Nonoperating Revenue (Expenses)</b>			
Interest on investments	138,601		138,601
State match	<u>10,872,140</u>		<u>10,872,140</u>
Total nonoperating revenue	<u>11,010,741</u>		<u>11,010,741</u>
Funds from EPA-Transfer-in	11,278,757		11,278,757
Funds from EPA-Transfer-out		<u>(11,580,410)</u>	<u>(11,580,410)</u>
Total transfers	<u>11,278,757</u>	<u>(11,580,410)</u>	<u>(301,653)</u>
Change in net assets	<u>22,003,390</u>	<u>(453,957)</u>	<u>21,549,433</u>
Net assets, beginning of year	<u>43,419,172</u>	<u>456,944</u>	<u>43,876,116</u>
Net assets, end of year	<u>\$ 65,422,562</u>	<u>\$ 2,987</u>	<u>\$ 65,425,549</u>

**STATE OF OREGON**  
**Safe Drinking Water Revolving Loan Fund**  
**Statement of Cash Flows**  
**For the year ended June 30, 2004**

	<b>Loans</b>
<b>Cash flows from operating activities:</b>	
Loan principal repayments	\$ 1,513,315
Loan interest received	1,059,086
Employee services and benefits	(252,307)
Services and supplies	(29,485)
Cash received from EPA-Program Admin	276,316
Loan disbursements	(16,359,493)
Net cash provided (used) by operating activities	(\$13,792,568)
<b>Cash flows from noncapital financing activities:</b>	
Funds received from EPA	11,278,757
Transfer from other State funds	10,872,140
Net cash provided (used) by noncapital financing activities	22,150,897
<b>Cash flows from investing activities:</b>	
Interest on investments	138,601
Net cash provided (used) by investing activities	138,601
Net cash provided (used)	8,496,930
Cash and cash equivalents, beginning of year	4,496,400
Cash and cash equivalents, end of year	\$ 12,993,330

**STATE OF OREGON**  
**Safe Drinking Water Revolving Loan Fund**  
**Statement of Cash Flows**  
**For the year ended June 30, 2004**

**Reconciliation of operating income (loss) to net cash provided (used) by operating activities**

Excess of revenue over expenses	\$ (286,108)
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**Adjustments to reconcile operating income to net cash used for operating activities**

Allowance for principal forgiveness	683,402
(Increase) decrease in Federal Receivable	(25,337)
(Increase) decrease in loan interest receivable	(99,453)
(Increase) decrease in loans receivable	(14,062,766)
Increase (decrease) in liabilities	16,279
Increase (decrease) in vacation payable	<u>(18,585)</u>
Total adjustments	(13,506,460)
 Net cash provided (used) for operating activities	 <u>\$ (13,792,568)</u>

**STATE OF OREGON**  
**Safe Drinking Water Revolving Loan Fund**  
**Notes to Financial Statements**

The accompanying financial statements of the Oregon Safe Drinking Water Revolving Loan Fund have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB), the Financial Accounting Standards Board (FASB), and the American Institute of Certified Public Accountants (AICPA). In accordance with GASB Statement No. 20, the Safe Drinking Water Revolving Loan Fund does not apply FASB pronouncements issued after November 30, 1989.

**1. Summary of Significant Accounting Policies**

**a. Reporting Entity**

The Safe Drinking Water Revolving Loan Fund (SDWRLF) was created in 1998 as a fund within the Oregon Economic and Community Development Department (OECD), which is part of the State of Oregon reporting entity. The SDWRLF operates under the provisions of sections 285B.530 through 285B.548 and 285B.560 through 285B.599 of the Oregon Revised Statutes (ORS).

In 1996 Congress created the Safe Drinking Water State Revolving Fund. The fund gives each state money to establish loan funds. The funds are to assist in the construction and improvement of local public water systems. These financial resources assist communities and nonprofit non-community drinking water systems in planning, designing, and building drinking water facilities to correct a noncompliance with current or future drinking water standards, or to further the public health protection goals of the Federal (US) Safe Drinking Water Act and Oregon's Drinking Water Quality Act. 1.

For these purposes, the State of Oregon receives an annual grant from the U. S. Environmental Protection Agency (USEPA) based on submissions by the State for each year's grant. Most of the grant is used to capitalize the loan financing program, for which a 20 percent match from the State is required. This match is currently met through State Lottery revenue bonds. These bonds will be repaid using State Lottery proceeds.

**b. Basis of Presentation**

The SDWRLF program at the Oregon Economic and Community Development Department is accounted for as an Enterprise Fund, a proprietary fund type. Enterprise Funds account for operations financed and operated in a manner similar to private business enterprises. Funds received by DHS and DEQ are not accounted for as an Enterprise Fund, but are accounted for under the State of Oregon Accounting Manual rules in the State Financial Management System (accounting system), which is the system of record.

**STATE OF OREGON**  
**Safe Drinking Water Revolving Loan Fund**  
**Notes to Financial Statements**

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

**c. Measurement Focus and Basis of Accounting**

All funds are accounted for on a flow of economic resources measurement focus, and are maintained on the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded at the time related liabilities are incurred. Financial activities of OECDD, DHS, and DEQ are included in this report in a “consolidated Format.” All assets and liabilities associated with the operation of this fund are included on the balance sheet. Fund equity (i.e. net total assets) is reported as Net Assets. Proprietary fund operating statements present increases (e.g. revenues) and decreases (e.g. expenses) in net assets.

**d. Budgetary Accounting**

The State of Oregon’s budgets are approved on a biennial basis. Safe Drinking Water Program expenditures are monitored against approved budgets, quarterly allotments, and cash advances. Limitations lapse at the end of the biennium. The Emergency Board of the Oregon Legislature approves any increases or decreases to the Legislatively approved budget when the Legislature is not in session. The SDWRLF has continuous spending authority in ORS 285B.563.

**e. Cash, Cash Equivalents, and Investments**

Cash and cash equivalents include: cash on hand, and cash held by the Oregon State Treasury. Investments are considered to be cash equivalents when the maturity date is within 90 days of the date of the date of acquisition. Investments are reported on the financial statements at fair value. Changes in the fair value of investments are recognized as revenue. The custodial agent determines the fair value of debt and equity securities, using pricing services, or prices quoted by one or more independent brokers.

**f. Receivables**

Receivables are amounts due representing revenues earned or accrued in the current period. Interest receivable includes interest due on loans to local governments and special districts. Loans receivable are shown net of an allowance for principal forgiveness. An allowance for un-collectible accounts is not established because the program has not had any defaults and none are anticipated.

**STATE OF OREGON**  
**Safe Drinking Water Revolving Loan Fund**  
**Notes to Financial Statements**

**2. Loans Receivable**

Loans Receivable: <u>Through June 30</u>	<u>2004</u>	2003 <u>(Unaudited)</u>	2002 <u>(Unaudited)</u>
Number of Loans Outstanding	46	39	34
Total Amount Outstanding	<u>\$51,693,209</u>	<u>\$38,313,845</u>	<u>\$16,949,277</u>

Loans Receivable project statuses at June 30, 2004 are as follows:

Loans in Repayment	\$ 31,982,124
Projects in Construction	20,923,899
Allowance for Principal Forgiveness	<u>(1,212,814)</u>
Total Loans Receivable	<u>\$ 51,693,209</u>

Loans mature at various intervals. The following schedule summarizes future loan repayments from loans in repayment.

<u>Fiscal Year ending June 30</u>	<u>Principal</u>	<u>Interest</u>
2005	\$ 1,281,381	\$ 961,592
2006	1,318,558	925,159
2007	1,355,822	887,328
2008	1,395,210	848,098
2009	1,435,774	807,379
Thereafter	<u>25,195,379</u>	<u>6,340,556</u>
Total Payments	<u>\$ 31,982,124</u>	<u>\$ 10,770,112</u>

**3. Employee Retirement Plan**

The Public Employees Retirement System (PERS) is a statewide defined benefit retirement plan for units of state government, school districts, community colleges, and political subdivisions of the State. PERS is administered by the Public Employees Retirement Board (Board) under the guidelines of Chapter 238 of the Oregon Revised Statutes, and it provides retirement and disability benefits, cost-of-living adjustments, and death benefits to plan members and beneficiaries.

PERS is a single pension plan that features both a cost-sharing multiple-employer pension plan and an agent multiple-employer pension plan. For units of state government, community colleges, and school districts, participation in the PERS cost-sharing multiple-employer plan is mandatory.

**STATE OF OREGON**  
**Safe Drinking Water Revolving Loan Fund**  
**Notes to Financial Statements**

**3. Employee Retirement Plan (continued)**

The PERS defined benefit retirement plan is reported in a pension trust fund of the State primary government. PERS issues a separate, publicly available financial report that includes audited financial statements and required supplementary information. That report may be obtained by writing to the Fiscal Services Division, Public Employees Retirement System, 11410 SW 68<sup>th</sup> Parkway, Tigard, Oregon 97223.

The PERS funding policy provides for plan contributions to accumulate sufficient assets to pay retirement benefits when due. Plan member contributions are established by State statute. The Board determines state employer contributions, based on an actuarially determined rate. As of June 30, 2002, employees of state agencies are required to contribute 6 percent of their salary to the plan and their State employers are required to contribute 4.71 percent. Current law permits employers to pay employee contributions to the retirement fund.

The employer contributions paid to PERS by the SDWRLF were equal to the required contributions for each year. No pension liability existed at June 30, 2004, determined in accordance with Statement No. 27 of the Governmental Accounting Standards Board.

**4. Unemployment Benefits**

State departments are subject to the Department of Employment Act. State employees who qualify are entitled to benefit payments during periods of unemployment. Each State Department is required to reimburse the Department of Employment for benefit payments made to their former employees. There were no expenses relating to these benefits for the year ended June 30, 2004.

**5. Commitments**

Projects awarded but not disbursed at June 30, 2004:

<u>Number of Projects</u>	<u>Amount of Funds</u>
29	\$ 38,272,943

**6. Federal Grants Available**

USEPA grants available to fund Safe Drinking Water projects at June 30, 2004, total \$45,348,264. As of June 30, 2004, OECDD SDWRLF has expended all the state matching moneys required to match the 1997 thru 2000 USEPA grants. State matching requirements for the USEPA grant years 2001 thru 2003 of \$7,954,300 is funded, of which \$6,629,727 remains available for disbursement as of June 30, 2004.

**STATE OF OREGON**  
**Safe Drinking Water Revolving Loan Fund**  
**Notes to Financial Statements**

**6. Federal Grants Available (continued)**

USEPA Grant Awards available at June 30, 2004:

2000 Grant Available	\$ 1,333,512
2001 Grant Available	9,247,925
2002 Grant Available	11,588,025
2003 Grant Available	11,179,251
2004 Grant Available	<u>\$11,999,551</u>
Total USEPA Grants Available	<u>\$45,348,264</u>





UNITED STATES ENVIRONMENTAL PROTECTION AGENCY  
WASHINGTON, D.C.

OFFICE OF  
INSPECTOR GENERAL

**Independent Auditor's Report  
on the Internal Control Structure  
Based on an Audit of the Financial Statements  
Performed in Accordance with *Government Auditing Standards***

We have audited the financial statements of the Oregon Safe Drinking Water Revolving Loan Fund Program (the Program) as of and for the year ended June 30, 2004, and have issued our report thereon dated February 9, 2005.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

Management for the Oregon Safe Drinking Water Revolving Loan Fund is responsible for establishing and maintaining an internal control structure. In fulfilling its responsibilities, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with Generally Accepted Accounting Principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit of the financial statements of the Oregon Safe Drinking Water Revolving Loan Fund for the year ended June 30, 2004, we obtained an understanding of the internal control structure. With respect to the internal control structure, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk 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 structure. Accordingly, we do not express such an opinion.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses under

standards established by the American Institute of Certified Public Accountants. 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 misstatements 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. We noted matters involving the internal control structure and its operations that we consider to be a material weakness as defined above. The material weakness is described in the accompanying schedule of Internal Control Finding and Recommendation.

This report is intended for the information of management of the Oregon Safe Drinking Water Revolving Loan Fund and the United States Environmental Protection Agency. However, this report is a matter of public record and distribution is not limited.

Office of Inspector General  
Environmental Protection Agency

February 9, 2005

## Internal Control Finding and Recommendation

### Lack of Documentation of Set-Aside Funds

The Oregon Safe Drinking Water Revolving Loan Fund Program's accounting system was unable to document and support the assets, liabilities, net assets, and revenues and expenditures of the Set-Aside fund in accordance with Generally Accepted Accounting Principles as required by Title 40 CFR 35.3550(i). The State of Oregon accounting system does not track revenues and expenditures on a fiscal year basis for grant type programs. The Program did provide set-aside information during the audit but was unable to reconcile it to the general ledger. Further, the information provided during the audit does not agree with the information provided in the financial statements.

**Recommendation:** We recommend that EPA require the Oregon Department of Human Services to develop a trial balance for the set-asides that is reconcilable to the general ledger. This may require working with the State's Controller to develop a general ledger report for set-asides from the State's accounting system.

**State Response:** Oregon agreed with our recommendation, and stated:

*Your recommendation . . . that the Department of Human Services develop a trial balance for the set-asides that is reconcilable to the general ledger has been reviewed and accepted by our financial services manager . . . . Enclosed are new financial statements that satisfy the recommended action presented in your audit report.*



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY  
WASHINGTON, D.C.

OFFICE OF  
INSPECTOR GENERAL

**Independent Auditor's Report  
on Compliance with the Requirements Applicable to the  
Environmental Protection Agency's State Revolving Fund Program  
in Accordance with *Government Auditing Standards***

We have audited the financial statements of the Oregon Safe Drinking Water Revolving Loan Fund Program (the Program) as of and for the year ended June 30, 2004, and have issued our report thereon dated February 9, 2005.

We have also audited the Program's compliance with requirements governing the following:

- Allowability for Specific Activities;
- Allowable Costs/Cost Principles;
- Cash Management;
- State Matching;
- Period of Availability of Funds and Binding Commitments;
- Program Income;
- Reporting;
- Sub-recipient Monitoring; and
- Special tests and provisions.

The above compliance requirements are applicable to the Oregon Safe Drinking Water Revolving Loan Fund Program for the year ended June 30, 2004. The management of the Program is responsible for compliance with those requirements. Our responsibility is to express an opinion on those requirements 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 material noncompliance with the requirements of the State Revolving Fund program occurred. 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 matters discussed in the findings and recommendation section that follows, the Program complied, in all material respects, with the specific program requirements listed above for the year ended June 30, 2004.

This report is intended for the information of management of the Oregon Safe Drinking Water Revolving Loan Fund Program and the United States Environmental Protection Agency. However, this report is a matter of public record and distribution is not limited.

Office of Inspector General  
Environmental Protection Agency

February 9, 2005

## Compliance Findings and Recommendation

### Lack of Proper Accounting for Set-Asides

The Oregon Safe Drinking Water Revolving Loan Fund Program has not complied with accounting requirements for set-aside activities. Title 40 CFR 35.3550(i) requires States to use accounting, audit, and fiscal procedures conforming to Generally Accepted Accounting Principles as promulgated by the Governmental Accounting Standards Board. The Program has been unable to provide a trial balance that lists assets, liabilities, equity, and revenues and expenses on a fiscal year basis because the State accounting system does not track revenues and expenditures on a fiscal year basis for grant programs. Further, set-aside information provided in the financial statements does not agree with information provided during the audit.

**Recommendation:** We recommend that EPA require the Oregon Department of Human Services to develop a trial balance for the set-asides that is reconcilable to the general ledger. This may require working with the State's Controller to develop a general ledger report for set-asides from the State's accounting system.

**State Response:** Oregon agreed with our recommendation, and has developed a system to properly account for set-aside costs, as discussed under the Internal Control Finding and Recommendation section.

### Technical and Managerial Capacity Determinations

The Program performs technical and managerial capacity determinations prior to execution of loan agreements in accordance with 40 CFR 35.3520 (d)(2), which states that assistance from the Fund may not be provided to systems that lack the technical, financial, and managerial capability to ensure compliance with requirements of the Safe Drinking Water Act, unless owners of the systems agree to undertake feasible and appropriate changes to ensure compliance over the long term. However, the determinations frequently identified deficiencies that needed to become loan conditions but in many cases were not. For example, one Department of Human Services managerial review determined that the loan recipient needed to develop a written emergency response plan, and identify the plan in the loan agreement. However, the plan was not identified because the program had insufficient procedures to ensure all requirements identified by the review were included in the final loan agreement.

**State Response:** Oregon agreed with our finding, and provided a list of corrective actions to make sure these requirements are met. The list included: (1) provide more training for project staff; (2) increase review by the Infrastructure Manager; (3) develop new eligibility checklists to identify the specific actions needed resulting from the technical and managerial capacity review; and (4) investigate creating a special condition in the contract that identifies capacity review letters and makes the letter an exhibit of the contract. These actions should be sufficient to correct the problem.

## Supplemental Information

### State of Oregon Drinking Water State Revolving Fund Schedule of Set-Aside Expenses (Unaudited) Year Ended June 30, 2004

<u>Cost Category</u>	<u>Administration</u>	<u>Technical Assistance</u>	<u>Program Management</u>	<u>Local Assistance</u>	<u>Total</u>
Payroll	\$ 131,963	\$ 0	\$ 103,246	\$ 383,013	\$ 618,222
Contracts	198,526	103,864	182,929	251,758	737,077
Other Operating Costs	<u>28,640</u>	<u>0</u>	<u>178,859</u>	<u>34,089</u>	<u>241,588</u>
	<u>\$ 359,129</u>	<u>\$ 103,864</u>	<u>\$ 465,034</u>	<u>\$ 668,860</u>	<u>\$ 1,596,887</u>

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