



A REPORT  
TO THE  
MONTANA  
LEGISLATURE

FINANCIAL-COMPLIANCE AUDIT

*Department of  
Environmental Quality*

*For the Two Fiscal Years Ended  
June 30, 2010*

SEPTEMBER 2010

LEGISLATIVE AUDIT  
DIVISION

10-16

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# LEGISLATIVE AUDIT DIVISION

Tori Hunthausen, Legislative Auditor  
Monica Huyg, Legal Counsel



Deputy Legislative Auditors  
James Gillett  
Angie Grove

September 2010

The Legislative Audit Committee  
of the Montana State Legislature:

This is our financial-compliance audit report on the Department of Environmental Quality for the two fiscal years ended June 30, 2010. Our report contains four recommendations related to recovering reclamation costs incurred by the General Fund from court ordered settlements with responsible parties, complying with regulations for the State Revolving Funds, and federal revenue recognition.

We thank the department director and staff for their assistance and cooperation during the audit.

Respectfully submitted,

*/s/ Tori Hunthausen*

Tori Hunthausen, CPA  
Legislative Auditor



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## APPOINTED AND ADMINISTRATIVE OFFICIALS

### Department of Environmental Quality

Richard Opper, Director  
 Tom Livers, Deputy Director  
 Dean Rude, Chief Financial Officer  
 John Arrigo, Enforcement Division Administrator  
 Judy Hanson, Permitting and Compliance Division Administrator  
 George Mathieus, Planning, Prevention and Assistance Division  
 Administrator  
 Sandi Olsen, Remediation Division Administrator

			<u>Term Expires</u>
<b>Board of Environmental Review</b>	Joe Russell, Chairman	Kalispell	January 1, 2011
	Larry Anderson	Great Falls	January 1, 2013
	Heidi Kaiser	Park City	January 1, 2011
	Marvin Miller	Butte	January 1, 2013
	Larry Mires	Glasgow	January 1, 2013
	Robin Shropshire	Helena	January 1, 2013
	Joseph Whalen	Miles City	January 1, 2013
<b>Petroleum Tank Release Compensation Board</b>	Roger Noble, Vice Presiding Officer	Kalispell	June 30, 2013
	Daniel Annala	Geyser	June 30, 2012
	Theresa Blazicevich	Stevensville	June 30, 2011
	Jerry Breen	Choteau	June 30, 2013
	Karl Hertel	Moore	June 30, 2013
	Roy Morris	Butte	June 30, 2012
	Steve Sendon	Bozeman	June 30, 2011

For additional information concerning the Department of  
 Environmental Quality, contact:

Lisa Peterson, Public Affairs Coordinator  
 Department of Environmental Quality  
 P.O. Box 200901  
 Helena, MT 59620-0901  
 e-mail: [lpeterson@mt.gov](mailto:lpeterson@mt.gov)

## FINANCIAL-COMPLIANCE AUDIT

## Department of Environmental Quality

For the Two Fiscal Years Ended June 30, 2010

SEPTEMBER 2010

10-16

REPORT SUMMARY

The Department of Environmental Quality (DEQ) administers environmental and natural resource functions of the state of Montana. The Department monitors environmental conditions, issues permits and assesses permit compliance for activities affecting Montana's environment. The department also enforces the state's environmental laws and works to ensure the remediation of environmental damage in the state.

### Context

DEQ has organized the promotion of environmental quality into four functional programs. The Planning Prevention and Assistance program develops air, water, waste management, and energy plans to protect Montana's resources. The Permitting and Compliance Program administers permitting and compliance related to state and federal environmental statutes. To enforce laws and the terms of permits granted, DEQ operates a small Enforcement Program, which has less than 8 percent of the FTE budgeted to permitting and compliance activities. The Remediation program oversees investigation and cleanup at state and federal Superfund sites, reclamation of abandoned mine lands, regulation of underground storage tanks, and remediation at sites where industrial and chemical spills have caused groundwater contamination.

### Results

The report discusses improvement of documentation for monitoring of State Revolving Fund (SRF) funded projects, an instance of non-compliance with state law

on competitive bidding by a local government, which resulted in \$418,072 of questioned federal costs on an SRF loan, and inconsistent federal revenue recognition in the SRF program.

The report discloses an instance where the department has not reimbursed \$1.42 million of remediation costs paid by the state's General Fund prior to a settlement, from the proceeds of the subsequent settlement, as required by state law.

Recommendation Concurrence	
Concur	3
Partially Concur	0
Do Not Concur	1
Source: Agency audit response included in final report.	

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# Chapter I – Introduction and Background

## **Introduction**

We performed a financial-compliance audit of the Department of Environmental Quality (department) for the two fiscal years ended June 30, 2010. The objectives of the audit were to:

1. Determine the department's compliance with selected state and federal laws and regulations.
2. Obtain an understanding of the department's control systems to the extent necessary to support our audit of the department's financial schedules and, if appropriate, make recommendations for improvements in management and internal controls of the department.
3. Determine the implementation status of prior audit recommendations.
4. Determine whether the department's financial schedules present fairly the results of operations and changes in fund balances for the two fiscal years ended June 30, 2010.

This report contains four recommendations to the department. In accordance with §5-13-307, MCA, we analyzed and disclosed, if significant, the costs of implementing the recommendations made in this report. Other areas of concern deemed not to have a significant effect on the successful operations of the department are not specifically included in the report, but have been discussed with management.

As required by §17-8-101(6), MCA, we audited and are reporting on the reasonableness of Internal Service Fund type fees and fund equity balances at the department. The statute requires fees and charges for services, which are deposited into Internal Service Funds, be based upon commensurate costs. The department has one Internal Service Fund, which funds the Central Management Program and is administered by the Office of Financial Services. We reviewed the Internal Service Fund activity and determined the rates are commensurate with costs and fund equity balances are reasonable for the operations of the fund.

## **Background**

The department administers certain environmental and natural resources functions of state government. The department is organized along the functional lines of planning, permitting, enforcement, and remediation. Total authorized full-time equivalent employees (FTE) for the department were 442.79 as of May 2010.

The **Planning, Prevention and Assistance Program** (84.50 FTE) develops air, water, waste management, and energy plans to protect Montana's resources. The program monitors environmental conditions, maintains data on the condition of Montana's environment, and encourages businesses and government units to adopt sound environmental practices.

**Permitting and Compliance Program** (209.03 FTE) administers the permitting and compliance activities related to various federal and state statutes, including air quality, water quality, solid waste, hazardous waste, junk vehicle, mining, mine reclamation, public water supply, and sanitation in subdivision laws. The program reviews and assesses all environmental permit applications, prepares appropriate environmental impact documents, and inspects facilities to determine compliance with permit terms and the underlying laws and regulations. The division is also responsible for financial assurance activities relative to some of the permitting programs.

**Enforcement Program** (15 FTE) implements and tracks the department's formal enforcement activities, investigates and validates citizen complaints, and ensures that spills are cleaned up. Environmental statutes administered by the department authorize administrative or judicial enforcement actions that may seek corrective actions and penalties for violations of permit requirements or standards. Enforcement actions are initiated against a wide range of regulated entities including public water suppliers, wastewater dischargers, air emissions sources, underground storage tank owners and operators, solid waste or hazardous waste management facilities, subdivisions, junk vehicle owners, asbestos abatement contractors, gravel pits, precious metal mines, and coal mines.

**Remediation Program** (62.76 FTE) is responsible for overseeing investigation and cleanup activities at state and federal Superfund sites; reclaiming abandoned mine lands; regulating, permitting, and licensing underground storage tanks; implementing corrective actions at sites with leaking underground storage tanks; and overseeing groundwater remediation at sites where agricultural and industrial chemical spills have caused groundwater contamination.

**Central Management Program** (65.50 FTE) consists of the director's office, a financial services office, and an information technology office. The director's office includes the director's staff, the deputy director, an administrative officer, a public information officer, a centralized legal services unit, and a centralized personnel office. The financial services office provides budgeting, accounting, payroll, internal auditing, procurement and contract management support to other divisions. The information technology office provides information technology services support to other divisions.

**Petroleum Tank Release Compensation Board** (6 FTE) oversees the Petroleum Tank Release Cleanup Fund, established by §75-11-313, MCA, which reimburses eligible owners for the costs of petroleum release cleanup. Fund administration is a joint responsibility of the Board and the department.

**Board of Environmental Review** (BER) is established by §2-15-3502, MCA, as a quasi-judicial board consisting of seven members appointed by the governor. BER reviews administrative decisions made by the department that are appealed to it by affected parties as provided by statute. BER is attached to the department for administrative purposes only.

### **Prior Audit Recommendations**

The prior financial-compliance audit report of the Department of Environmental Quality for the two fiscal years ended June 30, 2008, contained two recommendations. The department implemented both recommendations.



## Chapter II – Findings and Recommendations

### Reclamation Cost Recovery

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**The department should reimburse General Fund reclamation costs from settlement payments made by responsible parties.**

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The 2007 Legislature appropriated \$2 million from the state General Fund to conduct reclamation in the Upper Blackfoot Mining Complex. In December 2009, the department received \$16 million from parties responsible for the environmental damage as part of a court ordered settlement. Section 75-10-719(7), MCA, requires that funds received from responsible parties in settlement agreements be used to reimburse the department for state remediation expenses incurred at a site prior to the settlement.

The department should reimburse to the General Fund from the appropriate settlement account the amounts spent from the General Fund for reclamation at this site and the interest on these amounts since the date of the settlement to comply with state law. As of June 30, 2010, the department had spent \$1,420,969 and owed an estimated \$2,769 in interest. Department management said the appropriation did not specify reimbursement, so the department assumed no repayment to the General Fund was required.

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#### **RECOMMENDATION #1**

*We recommend the department reimburse the General Fund from payments made by responsible parties for remediation costs incurred in the Upper Blackfoot Mining Complex, including interest since settlement.*

---

### **State Revolving Fund**

The department administers federal funds for Drinking Water (DWSRF) and Water Pollution Control (WPCSRF) State Revolving Fund loan programs. The programs provide federal capitalization for a permanent source of financing for wastewater treatment, nonpoint source pollution control, and public water system projects. Both programs provide at or below market interest loans to eligible Montana local governments, municipalities, and water and sewer districts. These programs are funded with grants from the U.S. Environmental Protection Agency (EPA) and are matched with the proceeds of state general obligation bonds. Borrower loan repayments provide

cash to repay the bonds and fund loans for future projects. Combined, these programs received \$17,462,626 and \$46,946,915 during fiscal years 2008-09 and 2009-10, including \$151,587 and \$27,810,930 in American Recovery and Reinvestment Act funds.

We tested transactions and compliance related to 26 projects active during the 21 month period between July 1, 2008 and March 31, 2010. The following two sections discuss issues related to unallowable project expenditures and department project monitoring control procedures.

## **Project Procurement Practices**

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**The department disbursed a loan for sewer improvements for which the local government entity had not requested or received bids on the construction contract.**

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The department provided a \$501,708 loan to a county water and sewer district for improvements to its wastewater facility. Federal regulation, CFR40.35.3135(g), requires the department to commit or expend capitalization grant funds in accordance with state laws. Section 7-5-2301, MCA, states that a contract for construction in excess of \$50,000 may not be entered into by a county governing body without a bidding process. The district receiving the loan executed a labor and materials contract for the project construction and did not request bids for the work. As a result, the project did not meet the federal procurement requirements for a WPCSRF loan. We question the \$418,072 in federal funds loaned to this project. A department manager said the district did not bid the project because the contractor had done work on an earlier phase of the facility improvement that was under the bid limit and the additional work of this project was not bid. The manager said he should have detected the situation prior to approving the loan.

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### ***RECOMMENDATION #2***

*We recommend the department review State Revolving Fund loan applications to ensure applicants follow construction contract provisions in state law.*

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## Project Monitoring

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### **The department did not consistently complete and document project monitoring in the manner prescribed by department policy.**

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Federal regulations require the department to maintain effective control and accountability for all grant and subgrant assets to assure these assets are used solely for authorized purposes. To implement control over WPCSRF and DWSRF programs, the department has developed controls for monitoring the construction of projects funded with loans from these programs. Department policy states that inspections should be made at least once per quarter for projects that are active during that quarter and that final construction inspections of facilities should occur within 60 days after notification of project completion by the recipient. The department has developed checklists for checking administrative and construction management while construction is in progress and a checklist for the final inspection. Department program management said the checklists were prescribed by policy to attain proper oversight and ensure compliance with federal regulations applicable to the project.

Of the 26 project files reviewed, 22 should have had inspections. Of these projects for which inspections were due, 11 had inspections that were not completed within the policy required timeframes and eight did not have the checklist forms prescribed for site visits. Project managers indicated that the time frames are restricted due to staffing, travel and weather. Project managers furnished field notes for visits made when the checklists had not been completed and the information was not in the files. By not using the checklists and placing monitoring documentation in the files, there is greater risk that all matters on which management wanted oversight will not be addressed.

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#### ***RECOMMENDATION #3***

*We recommend the department complete and document project monitoring in the timeframes and format established in department policy to provide evidence of the monitoring required by federal regulation.*

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## State Revolving Fund Deferred Revenue

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**The department deferred revenue for reimbursement of project costs inconsistently between two loans made for the same project from the same funding source.**

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The department reduced federal revenue by \$16,456,485 in the Federal Special Revenue Fund for amounts related to American Recovery and Reinvestment Act (ARRA) funded State Revolving Fund (SRF) loans that may be forgiven at the completion of construction. The department did not defer revenue for other SRF loans, including those made to communities for the same projects as loans with a forgiveness provision.

Generally accepted accounting principles state that there is a presumption that an accounting principle, once adopted, will be used for all similar transactions and events. Department deferral of revenue related to ARRA funded loans that will be forgiven while recognizing revenue related to other ARRA funded loans on the same projects, is an inconsistent application of accounting principle to two parts of the same transaction and is inconsistent with revenue recognition accounting practice applied to other SRF loans since the inception of the program. The inconsistent deferral of ARRA loans resulted in a \$16,456,485 understatement of federal revenue in the Federal Special Revenue Fund in fiscal year 2009-10.

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### **RECOMMENDATION #4**

*We recommend the department recognize federal revenue for American Recovery and Reinvestment Act funds distributed as State Revolving Fund loans consistently for costs incurred on approved projects.*

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# Independent Auditor's Report and Department Financial Schedules



## LEGISLATIVE AUDIT DIVISION

Tori Hunthausen, Legislative Auditor  
Monica Huyg, Legal Counsel



Deputy Legislative Auditors  
James Gillett  
Angie Grove

## INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee  
of the Montana State Legislature:

We have audited the accompanying Schedules of Changes in Fund Balances, Schedules of Total Revenues & Transfers-In, and Schedules of Total Expenditures & Transfers-Out of the Department of Environmental Quality for each of the fiscal years ended June 30, 2010, and 2009. The information contained in these financial schedules is the responsibility of the department's management. Our responsibility is to express opinions on these financial schedules based on our audit.

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

As described in note 1, these financial schedules are prepared on the basis of Montana state accounting policy, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The schedules are not intended to be a complete presentation and disclosure of the department's assets, liabilities and cash flows.

As discussed in Note 6, the department deferred \$16,456,485 in federal revenue in the Federal Special Revenue Fund for American Recovery and Reinvestment Act (ARRA) funded State Revolving Fund loans for which construction costs had been incurred. Consequently, federal revenue connected with these loans is not recorded consistently with other ARRA loans associated with the same projects and other State Revolving Fund loans funded with federal moneys. As a result, federal revenue is understated by \$16,456,485 on the Schedule of Total Revenue & Transfers-In for the Fiscal Year ended June 30, 2010. In addition, Budgeted Revenue & Transfers-In, Total Additions, and Ending Fund Balance in the Federal Special Revenue Fund are understated by \$16,456,485 on the Schedule of Changes in Fund Balances for the Fiscal Year Ended June 30, 2010.

In our opinion, except for the effects of the federal revenue recognition matter discussed in paragraph 4, the financial schedules referred to above present fairly, in all material respects, the results of operations and changes in fund balances of the Department of Environmental Quality for each of the fiscal years ended June 30, 2010, and 2009, in conformity with the basis of accounting described in note 1.

Respectfully submitted,

*/s/ James Gillett*

James Gillett, CPA  
Deputy Legislative Auditor

August 20, 2010

DEPT OF ENVIRONMENTAL QUALITY  
SCHEDULE OF CHANGES IN FUND BALANCES  
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Debt Service Fund	Capital Projects Fund	Internal Service Fund	Private Purpose Trust Fund	Permanent Fund
FUND BALANCE: July 1, 2009	\$ (3,244,535)	\$ 254,696,242	\$ (3,455,399)	\$ 744,582	\$ 0	\$ 79,211	\$ 22,940,843	\$ 5,766,909
<b>ADDITIONS</b>								
Budgeted Revenues & Transfers-In	8,750	19,053,834	20,043,035		1,791	7,106,202		
Nonbudgeted Revenues & Transfers-In	234,707	57,378,771	45,071,071	1,200,943	750,181	9,056	704,292	2,054,148
Prior Year Revenues & Transfers-In Adjustments	519	1,651,641	20,331	(21,500)		(338)		
Direct Entries to Fund Balance	6,815,479	(9,175,953)	(2,009,351)	273,212		(273)	280	
Total Additions	<u>7,059,455</u>	<u>68,908,292</u>	<u>63,125,086</u>	<u>1,452,655</u>	<u>751,972</u>	<u>7,114,646</u>	<u>704,572</u>	<u>2,054,148</u>
<b>REDUCTIONS</b>								
Budgeted Expenditures & Transfers-Out	5,711,970	27,670,683	35,811,584			6,806,765		
Nonbudgeted Expenditures & Transfers-Out		15,571,681	45,146,315	1,404,969		200,664	415,394	
Prior Year Expenditures & Transfers-Out Adjustments	(4,480)	(342,270)	(103,739)			(1,097)		
Total Reductions	<u>5,707,490</u>	<u>42,900,094</u>	<u>80,854,160</u>	<u>1,404,969</u>	<u>0</u>	<u>7,006,332</u>	<u>415,394</u>	<u>0</u>
FUND BALANCE: June 30, 2010	<u>\$ (1,892,570)</u>	<u>\$ 280,704,441</u>	<u>\$ (21,184,473)</u>	<u>\$ 792,268</u>	<u>\$ 751,972</u>	<u>\$ 187,526</u>	<u>\$ 23,230,021</u>	<u>\$ 7,821,057</u>

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-9.

DEPT OF ENVIRONMENTAL QUALITY  
SCHEDULE OF CHANGES IN FUND BALANCES  
FOR THE FISCAL YEAR ENDED JUNE 30, 2009

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Debt Service Fund	Internal Service Fund	Private Purpose Trust Fund	Permanent Fund
FUND BALANCE: July 1, 2008	\$ <u>(2,290,705)</u>	\$ <u>160,260,095</u>	\$ <u>(4,594,076)</u>	\$ <u>597,641</u>	\$ <u>361,832</u>	\$ <u>7,031,737</u>	\$ <u>4,252,220</u>
ADDITIONS							
Budgeted Revenues & Transfers-In	8,574	17,490,965	32,119,961		6,144,779		
Nonbudgeted Revenues & Transfers-In	239,278	123,102,903	15,982,554	1,263,371	11,575	16,475,405	1,514,689
Prior Year Revenues & Transfers-In Adjustments	5,625	803,639	(7,402,285)		2,601	92,438	
Direct Entries to Fund Balance	<u>7,271,938</u>	<u>(944,358)</u>	<u>(160,566)</u>	<u>271,938</u>	<u>5,661</u>	<u>2,174,932</u>	
Total Additions	<u>7,525,415</u>	<u>140,453,149</u>	<u>40,539,664</u>	<u>1,535,309</u>	<u>6,164,616</u>	<u>18,742,775</u>	<u>1,514,689</u>
REDUCTIONS							
Budgeted Expenditures & Transfers-Out	8,474,142	31,363,376	23,839,240		6,110,348		
Nonbudgeted Expenditures & Transfers-Out	53,140	14,716,786	15,847,882	1,388,368	320,243	2,833,669	
Prior Year Expenditures & Transfers-Out Adjustments	<u>(48,037)</u>	<u>(63,160)</u>	<u>(286,135)</u>		<u>16,646</u>		
Total Reductions	<u>8,479,245</u>	<u>46,017,002</u>	<u>39,400,987</u>	<u>1,388,368</u>	<u>6,447,237</u>	<u>2,833,669</u>	<u>0</u>
FUND BALANCE: June 30, 2009	\$ <u>(3,244,535)</u>	\$ <u>254,696,242</u>	\$ <u>(3,455,399)</u>	\$ <u>744,582</u>	\$ <u>79,211</u>	\$ <u>22,940,843</u>	\$ <u>5,766,909</u>

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-9.

DEPT OF ENVIRONMENTAL QUALITY  
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN  
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Debt Service Fund	Capital Projects Fund	Internal Service Fund	Private Purpose Trust Fund	Permanent Fund	Total
<b>TOTAL REVENUES &amp; TRANSFERS-IN BY CLASS</b>									
Licenses and Permits	\$ 8,500	\$ 11,790,935							\$ 11,799,435
Taxes	918	1,911	\$ 2,737			\$ 218			5,784
Charges for Services		3,782,754	3,650	\$ 984,730		4,361,952			9,133,086
Investment Earnings		21,995,498		763	\$ 1,972		\$ 63,110	\$ 854,148	22,915,491
Fines and Forfeits	232,547	832,341							1,064,888
Monetary Settlements		34,083,817							34,083,817
Sale of Documents, Merchandise and Property		4,650	13,175						17,825
Rentals, Leases and Royalties		5,000							5,000
Grants, Contracts, and Donations		1,182,732	38,594				641,182		1,862,508
Transfers-in	635	3,743,493	1,845	193,950	750,000			1,200,000	5,889,923
Capital Asset Sale Proceeds	564								564
Non-monetary Settlements		24,079							24,079
Federal Indirect Cost Recoveries						2,743,972			2,743,972
Miscellaneous	812	96,838	15,478			8,778			121,906
Federal		540,198	65,058,958						65,599,156
<b>Total Revenues &amp; Transfers-In</b>	<b>243,976</b>	<b>78,084,246</b>	<b>65,134,437</b>	<b>1,179,443</b>	<b>751,972</b>	<b>7,114,920</b>	<b>704,292</b>	<b>2,054,148</b>	<b>155,267,434</b>
Less: Nonbudgeted Revenues & Transfers-In	234,707	57,378,771	45,071,071	1,200,943	750,181	9,056	704,292	2,054,148	107,403,169
Prior Year Revenues & Transfers-In Adjustments	519	1,651,641	20,331	(21,500)		(338)			1,650,653
<b>Actual Budgeted Revenues &amp; Transfers-In</b>	<b>8,750</b>	<b>19,053,834</b>	<b>20,043,035</b>	<b>0</b>	<b>1,791</b>	<b>7,106,202</b>	<b>0</b>	<b>0</b>	<b>46,213,612</b>
Estimated Revenues & Transfers-In	230,219	20,138,522	45,528,893		5,000	7,576,044			73,478,678
<b>Budgeted Revenues &amp; Transfers-In Over (Under) Estimated</b>	<b>\$ (221,469)</b>	<b>\$ (1,084,688)</b>	<b>\$ (25,485,858)</b>	<b>\$ 0</b>	<b>\$ (3,209)</b>	<b>\$ (469,842)</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ (27,265,066)</b>
<b>BUDGETED REVENUES &amp; TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS</b>									
Licenses and Permits	\$ (1,998)	\$ 69,387							\$ 67,389
Taxes	(809)								(809)
Charges for Services	(50,912)	249,833	(1,350)			38,722			236,293
Investment Earnings		(29,740)			\$ (3,209)				(32,949)
Fines and Forfeits	(167,750)	(288,415)							(456,165)
Sale of Documents, Merchandise and Property		(70)							(70)
Contributions and Premiums						(12,000)			(12,000)
Grants, Contracts, and Donations		(401,154)	(7,851)						(409,005)
Transfers-in		(11,622)							(11,622)
Bond Proceeds		(1)							(1)
Federal Indirect Cost Recoveries						(496,564)			(496,564)
Federal		(672,906)	(25,476,657)						(26,149,563)
<b>Budgeted Revenues &amp; Transfers-In Over (Under) Estimated</b>	<b>\$ (221,469)</b>	<b>\$ (1,084,688)</b>	<b>\$ (25,485,858)</b>	<b>\$ 0</b>	<b>\$ (3,209)</b>	<b>\$ (469,842)</b>	<b>\$ 0</b>	<b>\$ 0</b>	<b>\$ (27,265,066)</b>

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-9.

DEPT OF ENVIRONMENTAL QUALITY  
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN  
FOR THE FISCAL YEAR ENDED JUNE 30, 2009

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Debt Service Fund	Internal Service Fund	Private Purpose Trust Fund	Permanent Fund	Total
<b>TOTAL REVENUES &amp; TRANSFERS-IN BY CLASS</b>								
Licenses and Permits	\$ 6,000	\$ 10,615,835						\$ 10,621,835
Taxes	824	2,524	\$ 2,609		\$ 147			6,104
Charges for Services		2,857,113		\$ 1,058,185	3,850,953			7,766,251
Investment Earnings		8,912,864		2,673		\$ 179,376	\$ 314,689	9,409,602
Fines and Forfeits	245,696	1,465,010						1,710,706
Sale of Documents, Merchandise and Property		3,975	3,400					7,375
Rentals, Leases and Royalties		5,000						5,000
Contributions and Premiums					12,980			12,980
Grants, Contracts, and Donations		1,277,514	69,665			16,388,467		17,735,646
Transfers-in		3,782,136	146,388	202,513	8		1,200,000	5,331,045
Federal Indirect Cost Recoveries					2,283,575			2,283,575
Miscellaneous	957	112,475,536	1,708		11,292			112,489,493
Federal			40,476,460					40,476,460
Total Revenues & Transfers-In	<u>253,477</u>	<u>141,397,507</u>	<u>40,700,230</u>	<u>1,263,371</u>	<u>6,158,955</u>	<u>16,567,843</u>	<u>1,514,689</u>	<u>207,856,072</u>
Less: Nonbudgeted Revenues & Transfers-In	239,278	123,102,903	15,982,554	1,263,371	11,575	16,475,405	1,514,689	158,589,775
Prior Year Revenues & Transfers-In Adjustments	5,625	803,639	(7,402,285)		2,601	92,438		(6,497,982)
Actual Budgeted Revenues & Transfers-In	8,574	17,490,965	32,119,961	0	6,144,779	0	0	55,764,279
Estimated Revenues & Transfers-In	309,099	18,474,022	29,474,969		5,612,445			53,870,535
Budgeted Revenues & Transfers-In Over (Under) Estimated	<u>\$ (300,525)</u>	<u>\$ (983,057)</u>	<u>\$ 2,644,992</u>	<u>\$ 0</u>	<u>\$ 532,334</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 1,893,744</u>
<b>BUDGETED REVENUES &amp; TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS</b>								
Licenses and Permits	\$ (4,498)	\$ (51,470)						\$ (55,968)
Taxes	(809)							(809)
Charges for Services	(50,792)	(1,480,078)	\$ (502)		\$ 281,530			(1,249,842)
Investment Earnings		138,778						138,778
Fines and Forfeits	(244,426)	(13,230)						(257,656)
Sale of Documents, Merchandise and Property		(70)						(70)
Contributions and Premiums					980			980
Grants, Contracts, and Donations		(115,884)	(7,688)					(123,572)
Transfers-in		535,209						535,209
Federal Indirect Cost Recoveries					249,824			249,824
Miscellaneous		3,688						3,688
Federal			2,653,182					2,653,182
Budgeted Revenues & Transfers-In Over (Under) Estimated	<u>\$ (300,525)</u>	<u>\$ (983,057)</u>	<u>\$ 2,644,992</u>	<u>\$ 0</u>	<u>\$ 532,334</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 1,893,744</u>

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Additional information is provided in the notes to the financial schedules beginning on page A-9.

DEPT OF ENVIRONMENTAL QUALITY  
 SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT  
 FOR THE FISCAL YEAR ENDED JUNE 30, 2010

PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT	CENTRAL MANAGEMENT PROGRAM	ENFORCEMENT DIVISION	PERMITTING & COMPLIANCE DIVISION	PETRO TANK RELEASE COMPENSATION BOARD	PLANNING PREVENTION & ASSISTANCE DIVISION	REMEDIAATION DIVISION	Total
Personal Services							
Salaries	\$ 3,681,424	\$ 759,745	\$ 10,459,202	\$ 272,768	\$ 5,032,291	\$ 3,912,966	\$ 24,118,396
Employee Benefits	1,061,676	231,651	3,147,343	89,573	1,463,670	1,175,242	7,169,155
Personal Services-Other	(3,089)						(3,089)
<b>Total</b>	<b>4,740,011</b>	<b>991,396</b>	<b>13,606,545</b>	<b>362,341</b>	<b>6,495,961</b>	<b>5,088,208</b>	<b>31,284,462</b>
Operating Expenses							
Other Services	1,653,138	55,519	4,031,435	107,853	4,017,107	29,528,485	39,393,537
Supplies & Materials	253,062	28,010	411,298	6,283	264,959	180,802	1,144,414
Communications	194,898	13,797	243,465	8,731	113,321	110,731	684,943
Travel	27,752	5,690	238,658	5,390	164,037	114,660	556,187
Rent	1,386,300	18,851	178,467		46,693	102,545	1,732,856
Utilities	5,363		7,210			5,837	18,410
Repair & Maintenance	89,635	1,012	19,155	558	5,138	17,297	132,795
Other Expenses	513,832	263,259	3,358,194	89,339	1,828,647	1,677,699	7,730,970
<b>Total</b>	<b>4,123,980</b>	<b>386,138</b>	<b>8,487,882</b>	<b>218,154</b>	<b>6,439,902</b>	<b>31,738,056</b>	<b>51,394,112</b>
Equipment & Intangible Assets							
Equipment			80,933			24,580	105,513
Intangible Assets			88,249				88,249
<b>Total</b>			<b>169,182</b>			<b>24,580</b>	<b>193,762</b>
Grants							
From State Sources			1,473,211				1,473,211
<b>Total</b>			<b>1,473,211</b>				<b>1,473,211</b>
Benefits & Claims							
From State Sources				3,625,647			3,625,647
<b>Total</b>				<b>3,625,647</b>			<b>3,625,647</b>
From Other Sources							
Distrib from Priv Purp Trusts			415,394				415,394
<b>Total</b>			<b>415,394</b>				<b>415,394</b>
Transfers-out							
Fund transfers	1,844		482,950		45,817,760	2,023,020	48,325,574
<b>Total</b>	<b>1,844</b>		<b>482,950</b>		<b>45,817,760</b>	<b>2,023,020</b>	<b>48,325,574</b>
Debt Service							
Bonds			182,950		935,204	272,638	1,390,792
Loans				32,985			32,985
<b>Total</b>			<b>182,950</b>	<b>32,985</b>	<b>935,204</b>	<b>272,638</b>	<b>1,423,777</b>
Other Post Employment Benefits							
Other Post Employment Benefits	152,498						152,498
<b>Total</b>	<b>152,498</b>						<b>152,498</b>
<b>Total Expenditures &amp; Transfers-Out</b>	<b>\$ 9,018,333</b>	<b>\$ 1,377,534</b>	<b>\$ 24,818,115</b>	<b>\$ 4,239,127</b>	<b>\$ 59,688,827</b>	<b>\$ 39,146,502</b>	<b>\$ 138,288,438</b>
<b>EXPENDITURES &amp; TRANSFERS-OUT BY FUND</b>							
General Fund	\$ 353,547	\$ 593,772	\$ 1,932,586	\$	\$ 2,827,585	\$ 0	\$ 5,707,490
State Special Revenue Fund	1,202,260	479,295	14,355,166	4,239,127	1,881,169	20,743,078	42,900,094
Federal Special Revenue Fund	457,514	304,468	7,930,699		54,036,078	18,125,401	80,854,160
Debt Service Fund			182,950		943,995	278,023	1,404,968
Internal Service Fund	7,005,012		1,320				7,006,332
Private Purpose Trust Fund			415,394				415,394
<b>Total Expenditures &amp; Transfers-Out</b>	<b>9,018,333</b>	<b>1,377,534</b>	<b>24,818,115</b>	<b>4,239,127</b>	<b>59,688,827</b>	<b>39,146,502</b>	<b>138,288,438</b>
Less: Nonbudgeted Expenditures & Transfers-Out	199,344	25,042	1,197,021	(7,671)	46,036,824	15,288,463	62,739,023
Prior Year Expenditures & Transfers-Out Adjustments	(14,607)	(14)	8,717	(370,736)	(70,906)	(4,041)	(451,587)
<b>Actual Budgeted Expenditures &amp; Transfers-Out</b>	<b>8,833,596</b>	<b>1,352,506</b>	<b>23,612,377</b>	<b>4,617,534</b>	<b>13,722,909</b>	<b>23,862,080</b>	<b>76,001,002</b>
Budget Authority	14,833,414	1,402,258	34,296,283	5,023,064	40,997,691	43,437,815	139,990,524
Unspent Budget Authority	\$ 5,999,818	\$ 49,752	\$ 10,683,906	\$ 405,530	\$ 27,274,782	\$ 19,575,735	\$ 63,989,522
<b>UNSPENT BUDGET AUTHORITY BY FUND</b>							
General Fund	\$ 17,099	\$ 1,069	\$ 794,000	\$	\$ 7,833	\$	\$ 820,001
State Special Revenue Fund	2,245,571	35,536	4,578,612	405,530	748,238	8,313,285	16,326,772
Federal Special Revenue Fund	3,384,584	13,146	5,311,294		25,768,711	11,262,450	45,740,185
Capital Projects Fund					750,000		750,000
Internal Service Fund	352,564						352,564
Unspent Budget Authority	\$ 5,999,818	\$ 49,752	\$ 10,683,906	\$ 405,530	\$ 27,274,782	\$ 19,575,735	\$ 63,989,522

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-9.

DEPT OF ENVIRONMENTAL QUALITY  
 SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT  
 FOR THE FISCAL YEAR ENDED JUNE 30, 2009

PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT	CENTRAL MANAGEMENT PROGRAM	ENFORCEMENT DIVISION	PERMITTING & COMPLIANCE DIVISION	PETRO TANK RELEASE COMPENSATION BOARD	PLANNING PREVENTION & ASSISTANCE DIVISION	REMEDIATION DIVISION	Total
<b>Personal Services</b>							
Salaries	\$ 3,556,705	\$ 766,307	\$ 10,387,643	\$ 257,475	\$ 4,590,041	\$ 3,497,255	\$ 23,055,426
Employee Benefits	1,027,388	230,265	3,082,146	83,939	1,313,076	1,032,956	6,769,770
Personal Services-Other	71,508						71,508
<b>Total</b>	<b>4,655,601</b>	<b>996,572</b>	<b>13,469,789</b>	<b>341,414</b>	<b>5,903,117</b>	<b>4,530,211</b>	<b>29,896,704</b>
<b>Operating Expenses</b>							
Other Services	2,366,831	39,980	4,086,046	99,363	3,592,507	19,114,485	29,299,212
Supplies & Materials	166,643	7,733	365,739	4,002	138,342	179,173	861,632
Communications	57,109	13,811	266,472	5,399	92,527	79,624	514,942
Travel	42,348	6,704	280,567	8,160	203,220	121,686	662,685
Rent	1,323,123	13,989	146,684		50,635	57,878	1,592,309
Utilities	3,737		9,516			3,361	16,614
Repair & Maintenance	67,791	926	20,906	395	3,587	13,280	106,885
Other Expenses	(86,730)	214,519	3,121,840	78,630	1,614,867	1,369,403	6,312,529
<b>Total</b>	<b>3,940,852</b>	<b>297,662</b>	<b>8,297,770</b>	<b>195,949</b>	<b>5,695,685</b>	<b>20,938,890</b>	<b>39,366,808</b>
<b>Equipment &amp; Intangible Assets</b>							
Equipment			660,140			41,449	701,589
Intangible Assets	455,472						455,472
<b>Total</b>	<b>455,472</b>		<b>660,140</b>			<b>41,449</b>	<b>1,157,061</b>
<b>Grants</b>							
From State Sources			1,692,613				1,692,613
From Federal Sources						(4,396,814)	(4,396,814)
<b>Total</b>			<b>1,692,613</b>			<b>(4,396,814)</b>	<b>(2,704,201)</b>
<b>Benefits &amp; Claims</b>							
From State Sources				5,057,748		2,400,000	7,457,748
<b>Total</b>				<b>5,057,748</b>		<b>2,400,000</b>	<b>7,457,748</b>
<b>From Other Sources</b>							
Distrib from Priv Purp Trusts			2,833,669				2,833,669
<b>Total</b>			<b>2,833,669</b>				<b>2,833,669</b>
<b>Transfers-out</b>							
Fund transfers			188,988		15,927,871	8,808,762	24,925,621
<b>Total</b>			<b>188,988</b>		<b>15,927,871</b>	<b>8,808,762</b>	<b>24,925,621</b>
<b>Debt Service</b>							
Bonds			181,363		930,949	273,056	1,385,368
Loans				60,661			60,661
<b>Total</b>			<b>181,363</b>	<b>60,661</b>	<b>930,949</b>	<b>273,056</b>	<b>1,446,029</b>
<b>Other Post Employment Benefits</b>							
Other Post Employment Benefits	187,069						187,069
<b>Total</b>	<b>187,069</b>						<b>187,069</b>
<b>Total Expenditures &amp; Transfers-Out</b>	<b>\$ 9,238,994</b>	<b>\$ 1,294,234</b>	<b>\$ 27,324,332</b>	<b>\$ 5,655,772</b>	<b>\$ 28,457,622</b>	<b>\$ 32,595,554</b>	<b>\$ 104,566,508</b>
<b>EXPENDITURES &amp; TRANSFERS-OUT BY FUND</b>							
General Fund	\$ 1,179,157	\$ 539,264	\$ 1,660,056	\$	\$ 3,746,292	\$ 1,354,476	\$ 8,479,245
State Special Revenue Fund	1,114,795	408,050	15,420,939	5,655,772	2,112,440	21,305,007	46,017,002
Federal Special Revenue Fund	500,378	346,920	7,225,732		21,665,941	9,662,016	39,400,987
Debt Service Fund			181,363		932,949	274,056	1,388,368
Internal Service Fund	6,444,664		2,573				6,447,237
Private Purpose Trust Fund			2,833,669				2,833,669
<b>Total Expenditures &amp; Transfers-Out</b>	<b>9,238,994</b>	<b>1,294,234</b>	<b>27,324,332</b>	<b>5,655,772</b>	<b>28,457,622</b>	<b>32,595,554</b>	<b>104,566,508</b>
Less: Nonbudgeted Expenditures & Transfers-Out	317,611	(70)	3,499,024	(8,005)	16,946,552	14,404,976	35,160,088
Prior Year Expenditures & Transfers-Out Adjustments	(44,269)	(27)	(278,294)	(110,137)	(24,796)	76,837	(380,686)
<b>Actual Budgeted Expenditures &amp; Transfers-Out</b>	<b>8,965,652</b>	<b>1,294,331</b>	<b>24,103,602</b>	<b>5,773,914</b>	<b>11,535,866</b>	<b>18,113,741</b>	<b>69,787,106</b>
Budget Authority	14,268,319	1,314,890	32,482,224	6,289,216	49,089,100	39,774,485	143,218,234
Unspent Budget Authority	\$ 5,302,667	\$ 20,559	\$ 8,378,622	\$ 515,302	\$ 37,553,234	\$ 21,660,744	\$ 73,431,128
<b>UNSPENT BUDGET AUTHORITY BY FUND</b>							
General Fund	\$ 3,255	\$ 500	\$ 842,293	\$	\$ 56,663	\$	\$ 902,711
State Special Revenue Fund	1,161,147	11,709	3,974,510	515,302	591,998	2,775,945	9,030,611
Federal Special Revenue Fund	4,069,882	8,350	3,561,819		36,904,573	18,884,799	63,429,423
Internal Service Fund	68,383						68,383
Unspent Budget Authority	\$ 5,302,667	\$ 20,559	\$ 8,378,622	\$ 515,302	\$ 37,553,234	\$ 21,660,744	\$ 73,431,128

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-9.

# Department of Environmental Quality

## Notes to the Financial Schedules

### For the Two Fiscal Years Ended June 30, 2010

## **1. Summary of Significant Accounting Policies**

### **Basis of Accounting**

The department uses the modified accrual basis of accounting, as defined by state accounting policy, for its Governmental fund category (General, State Special Revenue, Federal Special Revenue, Debt Service, and Permanent) and certain liabilities of defined benefit pension plans and certain post employment healthcare plans. In applying the modified accrual basis, the department records:

- ◆ Revenues when it receives cash or when receipts are realizable, measurable, earned, and available to pay current period liabilities.
- ◆ Expenditures for valid obligations when the department incurs the related liability and it is measurable, with the exception of the cost of employees' annual and sick leave. State accounting policy requires the department to record the cost of employees' annual and sick leave when used or paid.

The department uses accrual basis accounting for its Proprietary (Internal Service) and Fiduciary (Private-Purpose Trust) fund categories. Under the accrual basis, as defined by state accounting policy, the department records revenues in the accounting period when realizable, measurable, and earned, and records expenses in the period incurred when measurable.

Expenditures and expenses may include: entire budgeted service contracts even though the department receives the services in a subsequent fiscal year; goods ordered with a purchase order before fiscal year-end, but not received as of fiscal year-end; and equipment ordered with a purchase order before fiscal year-end.

### **Basis of Presentation**

The financial schedule format is in accordance with the policy of the Legislative Audit Committee. The financial schedules are prepared from the transactions posted to the state's accounting system without adjustment.

The department uses the following funds:

### **Governmental Fund Category**

- ◆ **General Fund** – to account for all financial resources except those required to be accounted for in another fund.

- ◆ **State Special Revenue Fund** – to account for proceeds of specific revenue sources (other than private-purpose trusts) that are legally restricted to expenditures for specific state program purposes. Department State Special Revenue Funds include Petroleum Tank Release Cleanup, Air Quality Operating Fees, Montana Pollution Discharge Elimination System (MPDES) Permit Program, Montana Pole and Streamside Tailings Remedial Action, Subdivision Plat Review, Reclamation and Development, Orphan Share Fund, Junk Vehicle Disposal, Alternative Energy Revolving Loan Program, Hard Rock Mining Reclamation, trust funds initially funded with Office of Surface Mining grants, and various reclamation bond forfeiture and settlement accounts.
- ◆ **Federal Special Revenue Fund** – to account for activities funded from federal revenue sources. Department Federal Special Revenue Funds include federal assistance programs such as the Water Pollution Control and Drinking Water State Revolving Funds, Performance Partnership Grants, Abandoned Mine Lands Reclamation Grant, as well as other federal grants and agreements.
- ◆ **Debt Service Fund** – to account for accumulated resources for the payment of general long-term debt principal and interest. The department uses this fund to record debt service principal and interest payments for state Hard Rock Mining Reclamation Bonds, Energy Conservation Bonds, and Comprehensive Environmental Response, Compensation and Liability Bonds.
- ◆ **Permanent Fund** – to account for financial resources that are permanently restricted to the extent that only earnings, and not principal, may be used for purposes that support the department's programs. The legislature created a trust fund in fiscal year 2005-06 to cover the long-term costs of water treatment in the area of the Zortman-Landusky mines. The trust is financed from an annual transfer of \$1.2 million from the orphan share fund until fiscal year 2017-18 or until the balance reaches \$19.3 million.

### Proprietary Fund Category

- ◆ **Internal Service Fund** – to account for the financing of goods or services provided by one department or agency to other departments or agencies of state government or to other governmental entities on a cost-reimbursement basis. Department Internal Service Funds include indirect charges assessed against all units of the department by the Central Management Program for providing department-wide support functions and services.

### Fiduciary Fund Category

- ◆ **Private-Purpose Trust Fund** – to account for activity of any trust arrangement not properly reported in a pension fund or an investment trust fund where the principal and income benefit individuals, private organizations, or other governments. Department's private-purpose trust funds include financial assurances held in trust related to permitting activities.

## **2. General Fund Balance**

The negative fund balance in the General Fund does not indicate overspent appropriation authority. The department has authority to pay obligations from the statewide General Fund within its appropriation limits. The department expends cash or other assets from the statewide fund when it pays General Fund obligations. The department's outstanding liabilities exceed the assets it has placed in the fund, resulting in negative ending General Fund balances for each of the fiscal years ended June 30, 2009, and 2010.

## **3. Direct Entries to Fund Balance**

Direct entries to fund balances in the General, State Special Revenue, Federal Special Revenue Fund, and Debt Service funds include entries generated by SABHRS to reflect the flow of resources within individual funds shared by separate agencies.

## **4. Settlements**

The department recorded \$112,230,890 of settlements for remediation of environmental damage as miscellaneous revenue in the State Special Revenue Fund in fiscal year 2008-09. In fiscal year 2009-10, the department recorded \$34,083,817 of these settlements as monetary settlements revenue.

## **5. Accounting Entity Transfers**

The accounting entity transfers of \$15.8 million and \$45.1 million in fiscal years 2008-09 and 2009-10 in the Planning, Prevention, and Assistance Division program are related to the Federal Drinking and Clean Water State Revolving Fund programs.

## **6. State Revolving Fund Deferred Revenue**

The department deferred revenue in the Federal Special Revenue Fund in fiscal year 2009-10 on \$16,456,485 of federal reimbursements received for ARRA funded State Revolving fund loans for which a final certification of compliance had not been received from the borrower. The deferred amount represents the forgiveness portion of the loans which does not recycle to the SRF funds and will be recognized as revenue and expensed at final certification of compliance by the borrower.



DEPARTMENT OF  
ENVIRONMENTAL  
QUALITY

DEPARTMENT RESPONSE





Brian Schweitzer, Governor

P.O. Box 200901 • Helena, MT 59620-0901 • (406) 444-2544 • www.deq.mt.gov

September 10, 2010

Tori Hunthausen  
Legislative Auditor  
Room 160, State Capitol  
Helena, MT 59620-1705

**RECEIVED**

SEP 10 2010

**LEGISLATIVE AUDIT DIV.**

Dear Ms. Hunthausen:

I have reviewed the Financial-Compliance Audit of the Department of Environmental Quality (DEQ) for Fiscal Years 2009 and 2010. I have detailed below our response to each of the recommendations. I want to complement your audit staff for their professionalism and thoroughness. Thank you also for the productive discussion at the exit conference.

**Recommendation #1**

*We recommend the department reimburse the General Fund from payments made by responsible parties for remediation costs incurred in the Upper Blackfoot Mining Complex, including interest prior to the settlement.*

At this point the DEQ does not concur with this recommendation; however, our final determination is contingent on ongoing discussions between our legal staff and the Legislative Auditor's attorney.

This appropriation was authorized in House Bill 2 during the 2007 May Special Session. The bill did not indicate that the Legislature expected the DEQ to cost recover this money, nor was the appropriation designated as a loan or otherwise designated as an amount that should be paid back to the General Fund. The DEQ therefore did not believe it was the Legislature's intent to recover these costs for the General Fund. Furthermore, the full amount of the money received in the bankruptcy settlement is expected to be necessary to reimburse the future costs of cleanup on the Upper Blackfoot.

The DEQ's legal staff will continue discussions with the Legislative Audit Division counsel on whether the Comprehensive Environmental Cleanup and Responsibility Act requires reimbursement of the General Fund. We hope we can resolve these issues prior to the September 28 Legislative Audit Committee meeting. The DEQ will have a more formal response when these discussions are complete.

**Recommendation #2**

*We recommend the department review State Revolving Fund loan applications to ensure applicants follow construction contract provisions in state law.*

The DEQ concurs with this recommendation. The amount listed, \$501,708, was part of one large wastewater project involving two Water Pollution Control State Revolving Fund loans totaling \$13,500,000. When the local water and sewer district originally bid this project, the district included an additive alternate bid item for storage pond liner cover work, but removed the item when the bid amount was higher than expected. Later, when total project costs came in under the district's loan amount, the district could have added the work as a change order, but timing did not allow. The original pilot work for this piece of the project was over the procurement limit, but the district simply assigned the additional work to the original subcontractor rather than rebid this piece of work; this action did not comply with state bidding laws and the DEQ did not catch this. We believe this is an anomaly, and does not require a change in project oversight practices or procedures.

### **Recommendation #3**

*We recommend the department complete and document project monitoring in the timeframes and format established in department policy to provide evidence of the monitoring required by federal regulation.*

The DEQ concurs with this recommendation. Montana's two State Revolving Fund (SRF) programs have had clean annual Environmental Protection Agency (EPA) reviews every year. EPA's 2010 review of Montana's SRF Recovery Act projects was very complimentary of the programs and of the amount of inspections done in both programs on Recovery Act projects. We have met federal monitoring requirements, and have received recognition from EPA as being a national leader in project monitoring and inspection. However, we acknowledge the projects noted in this audit had at least some minor deficiencies. The majority of these deficiencies were in the Drinking Water State Revolving Fund program. Changes will be made within this program to assure we conduct timely project inspections, include documentation of the inspections in the project files, and ensure completion of all applicable checklist forms.

### **Recommendation #4**

*We recommend the department recognize federal revenue for American Reinvestment and Recovery Act funds distributed as State Revolving Fund (SRF) loans at the time it reimburses borrowers for costs incurred on approved projects.*

The DEQ concurs with this recommendation, based on the reasoning offered by the Legislative Audit Division at our audit exit conference. We have changed our accounting entries as recommended and we will apply the recommended accounting treatment to any new SRF loans that include forgiveness elements.

The State Revolving Fund programs are administered by the DEQ and the Department of Natural Resources and Conservation (DNRC) to provide low-interest loans to municipalities and water and sewer districts to finance construction of, and

improvements to, water and wastewater treatment facilities. These programs are capitalized primarily by grants from the EPA.

New SRF grants received from EPA under the Recovery Act added a new loan forgiveness component to the loans made by the State to borrowing communities. Neither EPA nor the Governmental Accounting Standards Board (GASB) provided clear accounting guidance for the new loan forgiveness portion. Accounting personnel from DEQ and DNRC discussed alternatives of how to record the loan forgiveness transactions in accordance with Generally Accepted Accounting Principals. DEQ and DNRC staff then met with the Department of Administration's Accounting Division to discuss these options, and came to agreement on what seemed the most reasonable and conservative accounting treatment.

The Legislative Audit Division determined that historic and internal consistency dictated a different accounting treatment. At DEQ's request, the Department of Administration contacted GASB to provide guidance, since this new loan forgiveness program is expected to become a permanent condition from EPA. GASB acknowledged that it did not have clear guidance on this issue; this is one of the issues in its work plans to address.

The accounting treatment the DEQ has been using is on its own an acceptable practice; however, after discussion with the Audit Division we understand your arguments regarding consistency and concur with your recommendation. We have changed our accounting practices accordingly.

Again, thank you for the professionalism of your office in conducting this audit. Please let me know if you have any questions regarding our response, and we will plan to discuss this response at the September 28 Audit Committee meeting.

Sincerely,

A handwritten signature in black ink, appearing to read "Richard H. Opper", with a long horizontal flourish extending to the right.

Richard H. Opper  
Director