



A REPORT  
TO THE  
MONTANA  
LEGISLATURE

LEGISLATIVE AUDIT  
DIVISION

17-25B

FINANCIAL AUDIT

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# *Montana Water Pollution Control and Drinking Water State Revolving Fund Programs*

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*Department of  
Environmental Quality  
Department of Natural  
Resources and Conservation*

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*For the Fiscal Year Ended  
June 30, 2018*

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MARCH 2019

## FINANCIAL AUDITS

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Financial audits are conducted by the Legislative Audit Division to determine if the financial statements included in this report are presented fairly and the agency has complied with laws and regulations having a direct and material effect on the financial statements. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States Government Accountability Office. Financial audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

The Single Audit Act Amendments of 1996 and the Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards require the auditor to issue certain financial, internal control, and compliance reports in addition to those reports required by *Government Auditing Standards*. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 2017, was issued March 23, 2018. The Single Audit Report for the two fiscal years ended June 30, 2019, will be issued by March 31, 2020.

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#### AUDIT STAFF

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MARY CURRIN  
NATALIE H. GIBSON

JOHN FINE  
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# LEGISLATIVE AUDIT DIVISION

Angus Maciver, Legislative Auditor  
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors:  
Cindy Jorgenson  
Joe Murray

March 2019

The Legislative Audit Committee  
of the Montana State Legislature:

This is the financial audit report of the Montana Water Pollution Control State Revolving Fund and Drinking Water State Revolving Fund programs (programs) for the fiscal year ended June 30, 2018. An annual audit of these programs is required by the United States Environmental Protection Agency.

This audit did not result in any audit recommendations. We issued an unmodified opinion on the financial statements for the fiscal year ended June 30, 2018. The issuance of an unmodified opinion means the reader can rely on the information presented.

We did not identify any deficiencies in internal control that we consider a material weakness. No instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* were identified.

The programs are jointly administered by the Department of Natural Resources and Conservation and the Department of Environmental Quality. The management of the departments are responsible for the preparation of the financial statements and the related notes.

The departments' written response to the audit is included in the audit report on page C-1. We thank the Directors and their staff for their cooperation and assistance throughout the audit.

Respectfully submitted,

*/s/ Angus Maciver*

Angus Maciver  
Legislative Auditor



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## APPOINTED AND ADMINISTRATIVE OFFICIALS

### **Department of Environmental Quality**

Shaun McGrath, Director  
Tom Livers, Director (through September 2018)  
George Mathieus, Deputy Director  
Brenda Thomas, Chief Financial Officer, Fiscal Services  
Kevin Smith, Bureau Chief, Engineering Bureau

### **Department of Natural Resources and Conservation**

John E. Tubbs, Director  
Kerry Davant, Deputy Director  
Rex Renk, Chief of Staff  
Patricia Greiberis, Chief Financial Officer, Financial Services Office  
Anna Miller, Bureau Chief, Loan & Financial Management Bureau

For additional information concerning the Montana Water Pollution Control and Drinking Water State Revolving Fund programs, contact:

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# MONTANA LEGISLATIVE AUDIT DIVISION

## FINANCIAL AUDIT

# Montana Water Pollution Control and Drinking Water State Revolving Fund Programs

For the Fiscal Year Ended June 30, 2018

MARCH 2019

17-25B

REPORT SUMMARY

The Montana State Revolving Fund programs provide low interest loans for the planning, design, and construction of water pollution control and drinking water projects for communities around the state. The loans receivable balance was approximately \$272.6 million in the Water Pollution Control State Revolving Fund program and \$160.3 million in the Drinking Water State Revolving Fund program.

### Context

The State Revolving Fund programs (programs) include the Water Pollution Control State Revolving Fund (WPCSRF) and the Drinking Water State Revolving Fund (DWSRF). The programs are jointly administered by the Department of Environmental Quality and the Department of Natural Resources and Conservation. An annual audit of these programs is required by the United States Environmental Protection Agency (EPA).

Loan agreements offered by the programs allow up to 30 years for repayment, and all repayments of interest and principal must remain in the revolving funds. Therefore, as loans are repaid, funds are recycled to be made available for additional projects.

In addition to the recycled funds, the programs are funded by federal capitalization grants from the EPA, which require a state match of funds. The state match is provided by the issuance of debt in the form of General Obligation Bonds, Revenue Anticipation Notes, and Bond Anticipation Notes.

There is a loan forgiveness component to the EPA's federal capitalization grant awards. During fiscal year 2018, the programs forgave

approximately \$2.8 million in loans in WPCSRF and approximately \$1.8 million in loans for the DWSRF programs. A portion of the loans is forgiven when the public entity meets certain requirements established by the EPA.

At June 30, 2018, the loans receivable balances were approximately \$272.6 million in the WPCSRF and \$160.3 million in the DWSRF. The associated state match requirement for the WPCSRF and DWSRF programs are approximately \$37.5 million and \$51 million, respectively, and the state has contributed additional funds of approximately \$65.1 million and over \$8.4 million, respectively. These additional funds are used to meet the needs of public entities in Montana. These amounts are cumulative over the life of the programs.

### Results

We audited the financial statements and note disclosures and determined whether the information was supported by the underlying accounting records. This process included reviewing the financial statement preparation process, comparing the activity on the financial statements to previous years, and reviewing

*(continued on back)*

the notes for consistency with the financial statements and supporting documentation. We also reviewed the notes and determined whether the required disclosures were present. We evaluated agency controls over information provided by the trustee bank and determined program compliance with selected, applicable state laws.

This audit did not result in any audit recommendations, and we issued an unmodified opinion on the financial statements for the fiscal year ended June 30, 2018. This means the reader can rely on the information presented in the financial statements.

For a complete copy of the report (17-25B) or for further information, contact the Legislative Audit Division at 406-444-3122; e-mail to [lad@mt.gov](mailto:lad@mt.gov); or check the web site at <https://leg.mt.gov/lad/audit-reports>  
Report Fraud, Waste, and Abuse to the Legislative Auditor's FRAUD HOTLINE  
Call toll-free 1-800-222-4446, or e-mail [LADHotline@mt.gov](mailto:LADHotline@mt.gov).

# Chapter I – Introduction

## **Introduction**

We performed a financial audit of the Montana Water Pollution Control State Revolving Fund (WPCSRF) and Drinking Water State Revolving Fund (DWSRF) programs (programs). The objectives of the audit were to:

1. Determine whether the programs' financial statements and related notes present fairly the financial position and results of operations of the programs for the fiscal year ended June 30, 2018.
2. Determine whether the programs complied with selected, applicable state laws that are direct and material to the determination of financial statement amounts.
3. Obtain an understanding of the programs' control systems to the extent necessary to support our audit of the programs' financial statements and, if appropriate, make recommendations for improvements in management and internal controls of the programs.
4. Determine whether supplementary information is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

We audited the financial statements and note disclosures and determined whether the information was supported by the underlying accounting records. This process included reviewing the financial statement preparation process, comparing the activity on the financial statements to previous years, and reviewing the notes for consistency with the financial statements and supporting documentation. We also reviewed the notes and determined whether the required disclosures were present. We evaluated agency controls over information provided by the trustee bank and determined program compliance with selected, applicable state laws.

The United States Environmental Protection Agency (EPA) requires us to conduct our audit in accordance with *Government Auditing Standards*, which includes issuance of our report on internal control over financial reporting and on compliance and other matters on page B-1.

## **Background**

The State Revolving Fund (SRF) programs operate as direct loan programs. Loans made to communities through the WPCSRF and DWSRF programs are funded by federal capitalization grants, state match, and state recycled funds. The programs are jointly administered by the Engineering Bureau of the Department of Environmental Quality (DEQ) and the Conservation and Resource Development Division of the Department of Natural Resources and Conservation (DNRC).

## WPCSRF

The WPCSRF program provides a flexible financing source in the form of loan money at reduced interest rates to finance the construction of publicly-owned water pollution control facilities, projects, and plans. Water pollution control loans are comprised of federal capitalization grants and state match funds and may be financed up to 30 years. As of June 30, 2018, the loans receivable balance for the WPCSRF program was approximately \$272.6 million.

Since inception, the WPCSRF program has issued General Obligation (GO) bonds, Revenue Anticipation Notes (RANs), and Bond Anticipation Notes (BANs) for use as state matching funds for the WPCSRF program. The cumulative state match requirement for the WPCSRF program is approximately \$37.5 million. In addition to the required match, the state has contributed additional funds of approximately \$65.1 million. The additional funding was in response to the needs of public entities in Montana.

DEQ and DNRC are allowed to use a portion of the WPCSRF federal capitalization grant funds for program administration. In addition, federal law allows for a designated amount of the federal capitalization grants to have a loan forgiveness component. The program may forgive an amount not to exceed 40 percent of the amount of the federal capitalization grant received by the state for the year for total loans. Loan forgiveness is awarded to a public entity based on affordability criteria which takes into consideration the user rate/median household income, the local unemployment rate, and population trends. The user rate is the rate used to determine the amount of the public entity's monthly sewer service bill. Each entity receives a consolidated score based on these criteria. Loan forgiveness is awarded to those entities with the highest scores until the maximum allowable amount has been reached.

## DWSRF

The DWSRF program was established for states to provide low interest rate loans to finance the entire cost of qualified projects or to refinance loans for community water systems and nonprofit non-community water systems. Drinking water loans are comprised of federal capitalization grants and state match funds and may be financed for up to 30 years. As of June 30, 2018, the outstanding balance of loans receivable for the DWSRF program was \$160.3 million.

Since inception, the DWSRF program has issued GO bonds, RANs, and BANs for use as state matching funds in the DWSRF program. The total required match to date in the DWSRF program is \$51 million. In addition to the required match, the state

has contributed additional funds of over \$8.4 million. The additional funding was in response to the needs of public entities in Montana.

Per federal regulations, DEQ and DNRC are given flexibility to set aside specified amounts of the DWSRF federal capitalization grants for specific purposes such as program administration, technical assistance to public water systems, capacity development, operator certification, and to assist in the development and implementation of local drinking water protection initiatives and other state programs. The goal of the set-asides is to enable states to improve water system management and operations.

Federal regulation allows the DWSRF program to have a loan forgiveness component. If the community meets certain program requirements, the DWSRF program may forgive an amount not to exceed 30 percent of the amount of the federal capitalization grant received by the state for the year for total loans. To receive loan forgiveness, the public entity must meet certain program requirements. These program requirements are based on user rates as compared to median household income. The user rate is the rate used to determine the amount of the public entity's monthly water service bill.

### **WPCSRF and DWSRF Programs**

In both programs, a special administration fee, in the form of a percentage of the loan amount, is added to the interest rate for each loan. This fee is used to fund administrative program costs not covered by the federal capitalization grant funds.

As of June 30, 2018, the programs had a combined total of approximately \$28.3 million in GO bonds principal outstanding. This debt is the obligation of the state of Montana and is not reflected in the programs' financial statements, but the debt is described in the notes.

Tables 1 and 2 (see pages 4 and 5) are provided for informational purposes. The tables contain information concerning the loans closed during fiscal year 2018 for the programs. Programs' personnel define a project as closed when the program has granted a loan, and the recipient is drawing funds. Information specific to the programs includes the amount of loan forgiveness by the respective programs and the amount available to loan for the project. Columns highlighted in green represent SRF funding.

Table 1  
**Water Pollution Control State Revolving Fund Projects Closed as of June 30, 2018**

Project Sponsor	Project Description	County	Total Project Cost	Renewable Resource Grant & Loan*	Treasure State Endowment Program State *	State Revolving Fund Loan Forgiven	State Revolving Fund Loan Regular**	Water Pollution Control State Revolving Fund Loan C Regular**	Rural Development Grant*	Rural Development Loan*	Community Funds Local*	Coal Board*
Big Timber, City of	Wastewater Treatment Plant Rehabilitation	Sweet Grass	\$3,684,800				\$3,486,000				\$198,800	
Colstrip, City of	Wastewater Treatment Plant Rehabilitation	Rosebud	\$2,421,000			\$107,000	\$987,000				\$827,000	\$500,000
Cut Bank, City of	Wastewater Project	Glacier	\$16,545,000	\$125,000	\$625,000	\$400,000	\$3,000,000		\$1,472,000	\$9,998,000	\$925,000	
Dawson County	Wastewater Improvements	Dawson	\$3,931,000	\$100,000	\$750,000	\$400,000	\$2,681,000					
Great Falls, City of	Wastewater Storm Drain	Cascade	\$3,270,000				\$3,270,000					
Livingston, City of	Wastewater Treatment Plant	Park	\$19,505,000	\$125,000	\$625,000	\$400,000	\$6,500,000	\$4,840,000	\$1,715,000	\$5,000,000	\$300,000	
Livingston, City of	Wastewater Treatment Plant Rehabilitation	Park	\$5,000,000				\$5,000,000					
Plentywood, City of	Sewer Lines	Sheridan	\$2,690,444			\$400,000	\$2,237,000				\$53,444	
Resource Development Bureau	Various	Various	\$1,000,000				\$1,000,000					
Red Lodge, City of	Wastewater Improvements	Carbon	\$1,449,500			\$314,500	\$989,000				\$146,000	
Shelby, City of	Storm Sewer	Toole	\$648,000			\$300,000	\$348,000					
Terry, Town of	Wastewater Project Inflow & Infiltration	Prairie	\$905,000	\$81,000		\$164,000	\$660,000					
Vaughn Cascade County Water and Sewer District	Engineering/Land	Cascade	\$52,000				\$52,000					
Vaughn Cascade County Water and Sewer District	Sewer Lines	Cascade	\$2,905,000	\$10,000	\$750,000	\$400,000	\$1,745,000					
		<b>Totals</b>	<b>\$64,006,744</b>	<b>\$441,000</b>	<b>\$2,750,000</b>	<b>\$2,885,500</b>	<b>\$31,955,000</b>	<b>\$4,840,000</b>	<b>\$3,187,000</b>	<b>\$14,998,000</b>	<b>\$2,450,244</b>	<b>\$500,000</b>
						<b>State Revolving Fund Total</b>		<b>\$39,680,500</b>				

Source: Compiled by the Legislative Audit Division from information provided by program personnel.

\*Indicates funding source other than Water Pollution Control State Revolving Fund Program Loan.

\*\*The amounts in the State Revolving Fund Loan column represent the amount available for loan for the project from the Water Pollution Control State Revolving Fund Program. The project sponsor is not required to borrow the full amount.

Table 2  
**Drinking Water State Revolving Fund Projects Closed as of June 30, 2018**

Project Sponsor	Project Description	County	Total Project Cost	Treasure State Endowment Program State Grant*	Treasure State Regional Water Grant*	State Revolving Fund Loan Forgiven	Drinking Water State Revolving Fund Loan B Regular**	Drinking Water State Revolving Fund Loan C Regular**	Federal Army Corp Water Resources Development Act*	Community Funds Local*	Coal Severance Tax Water Development Loans*
Conrad, City of	Water Distribution System II	Pondera	\$2,337,000	\$500,000		\$500,000	\$897,000		\$190,000	\$250,000	
Cut Bank, City of	Resource Development Loan Refinance	Glacier	\$866,312				\$866,312				
Denton, Town of	Engineering	Fergus	\$182,000				\$182,000				
Dry Redwater Regional Water System	Water System Improvements	Richland	\$1,182,825		\$859,100		\$75,000			\$248,725	
Froid, Town of	Water Tank	Roosevelt	\$503,772			\$174,000	\$174,000				\$155,772
Fromberg, Town of	Water System Improvements	Carbon	\$867,152			\$171,800	\$652,800			\$42,552	
Great Falls, City of	Drinking Water Treatment Plant	Cascade	\$18,600,000				\$10,000,000	\$8,600,000			
Harlowton, City of	Engineering	Wheatland	\$100,000				\$100,000				
Lockwood Water & Sewer District	Water System Improvements	Yellowstone	\$3,462,075				\$2,000,000			\$1,462,075	
Malta, City of	Watermain Replacement	Philips	\$690,000				\$690,000				
Ramsey Water & Sewer District	Water Tank	Butte-Silver Bow	\$262,500			\$59,750	\$202,750				
Ronan, City of	Water Supply Filtration	Lake	\$1,150,000			\$500,000	\$650,000				
Three Forks, City of	Tank Work & Miscellaneous Water Improvements	Gallatin	\$327,000					\$100,000		\$227,000	
Upper Lower River Road Water & Sewer District	Water Lines	Cascade	\$288,075			\$145,000	\$143,075				
		<b>Totals</b>	<b>\$30,818,711</b>	<b>\$500,000</b>	<b>\$859,100</b>	<b>\$1,550,550</b>	<b>\$16,632,937</b>	<b>\$8,700,000</b>	<b>\$190,000</b>	<b>\$2,230,352</b>	<b>\$155,772</b>
						<b>State Revolving Fund Total</b>	<b>\$26,883,487</b>				

Source: Compiled by the Legislative Audit Division from information provided by program personnel.

\*Indicates funding source other than Water Pollution Control State Revolving Fund Program Loan.

\*\*The amounts in the State Revolving Fund Loan column represent the amount available for loan for the project from the Water Pollution Control State Revolving Fund Program. The project sponsor is not required to borrow the full amount.

**Independent Auditor's Report,  
Program Financial Statements, and  
Supplementary Information**





# LEGISLATIVE AUDIT DIVISION

A-1

Angus Maciver, Legislative Auditor  
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors:  
Cindy Jorgenson  
Joe Murray

## INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee  
of the Montana State Legislature:

### *Introduction*

We have audited the accompanying Montana Water Pollution Control and Drinking Water State Revolving Fund Programs' (programs) Combined Balance Sheet–Special Revenue and Debt Service Funds as of June 30, 2018, and the related Combined Statement of Revenues, Expenditures, and Changes in Fund Balances–Special Revenue and Debt Service Funds for the fiscal year then ended, and the related notes to the financial statements.

### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this responsibility includes designing, implementing, and maintaining internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditor's Responsibility*

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

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

of significant accounting estimates made by management, as well as the overall presentation of the financial statements.

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

### *Opinion*

In our opinion, the financial statements referred to above present fairly, in all material respects, the fund balances of the Montana Water Pollution Control and Drinking Water State Revolving Fund Programs as of June 30, 2018, and the changes in fund balances for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

### *Emphasis of Matter*

As discussed in Note 2A, the financial statements present the fund balances and changes in fund balances of only that portion of the reporting entity of the state of Montana that is attributable to the transactions of the programs' special revenue and debt service funds. The financial statements do not purport to, and do not, present fairly the financial position of the state of Montana as of June 30, 2018, or the changes in its financial position for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

### *Other Matters*

#### *Supplementary Information*

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The Montana Water Pollution Control and Drinking Water Schedule of Revolving and Non-Revolving SRF Programs Balance Sheet—Special Revenue and Debt Service Funds—Regulatory Basis as of June 30, 2018, and the related Schedule of Revolving and Non-Revolving SRF Program Revenues, Expenditures, and Changes in Fund Balances—Special Revenue and Debt Service Funds—Regulatory Basis, for the fiscal year then ended are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

*Other Reporting Required by Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated February 15, 2019, on our consideration of the programs' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the programs' internal control over financial reporting and compliance.

Respectfully submitted,

*/s/ Cindy Jorgenson*

Cindy Jorgenson, CPA  
Deputy Legislative Auditor  
Helena, MT

February 15, 2019



MONTANA WATER POLLUTION CONTROL AND DRINKING WATER  
STATE REVOLVING FUND PROGRAMS  
COMBINED BALANCE SHEET  
SPECIAL REVENUE AND DEBT SERVICE FUNDS  
JUNE 30, 2018

	WATER POLLUTION CONTROL				DRINKING WATER				(MEMORANDUM ONLY) TOTAL
	STATE SPECIAL REVENUE	FEDERAL SPECIAL REVENUE	DEBT SERVICE	TOTAL	STATE SPECIAL REVENUE	FEDERAL SPECIAL REVENUE	DEBT SERVICE	TOTAL	
<b>ASSETS</b>									
Cash and Cash Equivalents	\$24,769,068	\$6	\$4,401,227	\$283,942	\$10,472,341	\$84	\$1,002,166	\$958,973	\$40,644,880
Interest Receivable on Loans	282,682		1,155,304						\$2,680,902
Due from Federal Government			3,521			79,445			\$82,966
Investments									\$9,717,358
Loans Receivable	\$272,612,283	\$5,566,730		9,717,358					\$432,946,935
Less Allowance for Loan Forgiveness	0	(5,566,730)	0		\$160,334,652	\$5,171,706			\$4,292,500
Advances to Other Funds	4,292,500				160,334,652	(5,171,706)			\$4,292,500
Prepaid Expense									\$2,522
<b>Total Assets</b>	<b>\$301,956,533</b>		<b>\$5,556,531</b>	<b>\$180,808,294</b>	<b>\$180,808,294</b>	<b>\$82,050</b>	<b>\$1,961,139</b>	<b>\$490,366,074</b>	<b>\$490,366,074</b>
<b>LIABILITIES AND FUND BALANCES</b>									
<b>Liabilities:</b>									
Accounts Payable	\$642								\$952
Loans Payable	17,130				\$15,000				\$54,255
Vouchers Payable	8,603	\$625			32				\$12,893
Payroll Payable	33,894	2,788			32,578				\$125,012
Due to Other BU or Fund			\$2,192				\$33,248		\$35,440
Unearned Revenue		27							\$343
Advance from BAN (Intercep) Payable			450,000				1,250,000		\$1,700,000
<b>Total Liabilities</b>	<b>\$60,269</b>	<b>\$3,527</b>	<b>\$452,192</b>	<b>\$47,611</b>	<b>\$47,611</b>	<b>\$82,049</b>	<b>\$1,283,248</b>	<b>\$1,961,139</b>	<b>\$1,928,895</b>
<b>Fund Balances:</b>									
Fund Balance-Restricted	301,896,264		5,104,339		180,760,683		677,891		488,439,179
		0				1			
<b>Total Liabilities and Fund Balances</b>	<b>\$301,956,533</b>	<b>\$3,527</b>	<b>\$5,556,531</b>	<b>\$180,808,294</b>	<b>\$180,808,294</b>	<b>\$82,050</b>	<b>\$1,961,139</b>	<b>\$490,366,074</b>	<b>\$490,366,074</b>

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

**MONTANA WATER POLLUTION CONTROL AND DRINKING WATER  
STATE REVOLVING FUND PROGRAMS  
COMBINED STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES  
SPECIAL REVENUE AND DEBT SERVICE FUNDS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2018**

		<b>WATER POLLUTION CONTROL</b>				<b>DRINKING WATER</b>				(MEMORANDUM ONLY)
REVENUES:		STATE SPECIAL REVENUE	FEDERAL SPECIAL REVENUE	DEBT SERVICE	STATE SPECIAL REVENUE	FEDERAL SPECIAL REVENUE	DEBT SERVICE	TOTAL		
Federal Capitalization Grant Revenue									\$17,435,600	
Interest Income on Investments		\$159,415	\$8,334,701	\$31,564	\$262,268	\$91,100,900	\$6,592		\$459,839	
Investment Gain/Losses				(8,844)	(14,318)				(\$23,162)	
Investment Appr/Depr Income		3,542		554	(104,921)				(\$100,825)	
Interest Income from Loans		1,385,340		5,985,418	808,130		3,190,945		\$11,369,833	
Other Income			11			451			\$462	
<b>TOTAL REVENUES</b>		<b>\$1,548,297</b>	<b>\$8,334,711</b>	<b>\$6,008,692</b>	<b>\$951,159</b>	<b>\$91,101,351</b>	<b>\$3,197,537</b>		<b>\$29,141,747</b>	
<b>EXPENDITURES:</b>										
Program Administration/Set-Asides		\$945,180	\$251,205		\$596,555	\$1,992,598			\$3,785,538	
<b>TOTAL EXPENDITURES</b>		<b>\$945,180</b>	<b>\$251,205</b>	<b>\$0</b>	<b>\$596,555</b>	<b>\$1,992,598</b>	<b>\$0</b>		<b>\$3,785,538</b>	
<b>Excess Revenues Over (Under) Expenditures</b>		<b>\$603,117</b>	<b>\$8,083,506</b>	<b>\$6,008,692</b>	<b>\$354,604</b>	<b>\$7,108,753</b>	<b>\$3,197,537</b>		<b>\$25,356,209</b>	
<b>OTHER FINANCING SOURCES:</b>										
<b>Operating Transfers In:</b>										
BAN (Intercep) Transfers		\$2,900,000			\$1,900,000				\$4,800,000	
Debt Service Sweeps		83,408			142,705				\$226,113	
Federal Capitalization Grant Transfers		5,302,246		\$16,546	5,259,549		\$104,930		\$10,561,796	
Investment Earnings Transfers		21,803		10,000	5,140		62,500		\$148,418	
Investment Fund (Account) Transfer									\$72,500	
<b>Total Other Financing Sources</b>		<b>\$8,307,457</b>	<b>\$0</b>	<b>\$26,546</b>	<b>\$7,307,394</b>	<b>\$0</b>	<b>\$167,430</b>		<b>\$15,808,827</b>	
<b>OTHER FINANCING USES:</b>										
Bond Principal				\$1,295,000			\$1,295,000		\$2,590,000	
Bond/BAN (Intercep) Interest				1,245,607			150,845		\$1,396,452	
Loan Forgiveness			\$2,781,260			\$1,849,203			\$4,630,463	
<b>Operating Transfers Out:</b>										
BAN (Intercep) Transfer				2,900,000			1,900,000		\$4,800,000	
Debt Service Sweeps				83,408			142,705		\$226,113	
Federal Capitalization Grant Transfers		16,546	5,302,246	21,803	104,930	5,259,549	5,140		\$10,561,796	
Investment Earnings Transfers		10,000			62,500				\$148,418	
Investment Fund (Account) Transfer									\$72,500	
<b>Total Other Financing Uses</b>		<b>\$26,546</b>	<b>\$8,083,506</b>	<b>\$5,545,818</b>	<b>\$167,430</b>	<b>\$7,108,752</b>	<b>\$3,493,690</b>		<b>\$24,425,742</b>	
<b>Excess (deficiency) of Revenues and Other Financing Sources over (under) Expenditures and Other Financing Uses</b>		<b>\$8,884,028</b>	<b>\$0</b>	<b>\$489,421</b>	<b>\$7,494,568</b>	<b>\$1</b>	<b>(\$128,723)</b>		<b>\$16,739,294</b>	
<b>FUND BALANCES JULY 1, 2017</b>										
<b>PRIOR YEAR ADJUSTMENTS</b>		294,012,236	0	5,442,091	174,266,115	0	2,389,526		476,109,968	
		(1,000,000)		(827,173)	(1,000,000)		(1,582,911)		(4,410,084)	
<b>FUND BALANCES JUNE 30, 2018</b>		<b>\$301,896,264</b>	<b>\$0</b>	<b>\$5,104,339</b>	<b>\$180,760,683</b>	<b>\$1</b>	<b>\$677,891</b>		<b>\$488,439,178</b>	

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

**MONTANA STATE WATER POLLUTION CONTROL AND  
DRINKING WATER STATE REVOLVING FUND PROGRAMS  
NOTES TO FINANCIAL STATEMENTS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2018**

## **1. Organization of the Programs**

The State of Montana Water Pollution Control State Revolving Fund (WPCSRF) program was established pursuant to Title VI of the Federal Water Quality Act of 1987. This federal act established the WPCSRF program to replace the construction grants program. It provides a flexible financing source to loan money at reduced interest rates to finance the construction of publicly owned water pollution control facilities, non-point source pollution control projects, and estuary management plans. Instead of making grants to communities that pay for a portion of building wastewater treatment facilities, the WPCSRF provides for low interest rate loans to finance the entire cost of qualified projects or to refinance debt obligations on projects. The State of Montana first incurred expenditures in the WPCSRF program in state fiscal year (SFY) 1992.

The State of Montana Drinking Water State Revolving Fund (DWSRF) program was established pursuant to the 1996 Amendments to the Federal Safe Drinking Water Act. This federal act established the DWSRF program for states to make loans to community water systems and non-profit non-community water systems. Instead of making grants to communities that pay for a portion of building drinking water treatment facilities, the DWSRF provides for low interest rate loans to finance the entire cost of qualified projects or to refinance debt obligations on projects that began after July 1, 1993. The State of Montana first incurred expenditures in the DWSRF program in SFY 1997.

WPCSRF and DWSRF loan agreements allow up to 30 years for repayment. All repayments of interest and principal must remain in the revolving funds. Both programs are capitalized through Environmental Protection Agency (EPA) grants. States are required to provide at least 16.67 percent of the federal capitalization grant as matching funds for WPCSRF, and at least 20 percent for DWSRF, in order to receive a grant. The State of Montana issues General Obligation (GO) Bonds, Revenue Anticipation Notes (RANs), and Bond Anticipation Notes (BANs) to provide the required state matching funds. RANs and BANs are funded through INTERCAP Loans from the Montana Department of Commerce, Board of Investments.

The programs are jointly administered by the Engineering Bureau of the Department of Environmental Quality (DEQ) and the Conservation and Resource Development Division of the Department of Natural Resources and Conservation (DNRC). The State Revolving Fund (SRF) programs do not have any full-time employees. Both funds are charged for time spent on SRF activities by department employees. The charges include salaries and benefits of the employees, operating expenses and indirect costs.

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



### **A. SRF Program Fund Structure**

Both programs use Special Revenue and Debt Service funds, as appropriate, to report the financial position and the results of operations. A Special Revenue Fund accounts for the proceeds of specific revenue sources that are restricted to expenditures for specified purposes. A Debt Service Fund accounts for resources accumulated for payment of principal and interest on general long-term obligation debt, BANs and RANs. Montana maintains State Special Revenue and Federal Special Revenue Funds. The SRF program revenues and expenses include transactions from each Special Revenue Fund. Special Revenue and Debt Service Funds are considered governmental funds.

A fund is a separate accounting entity with a self-balancing set of accounts. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions and activities.

The financial statements are intended to present the financial position and changes in financial position of only that portion of the financial reporting entity of the state of Montana that is attributed to the transactions of the program.

### **B. Basis of Accounting**

The accompanying financial statements have been prepared in conformity with Generally Accepted Accounting Principles (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB). Also exhibited are supplementary financial schedules prepared on a regulatory basis of presentation as requested by the EPA for the WPCSRF and DWSRF program. The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. All governmental funds are accounted for using a current financial resources measurement focus. Current financial resources means that, generally, only assets and current liabilities are included on the balance sheet. Operating statements of governmental funds present increases (revenues and other financing sources) and decreases (expenditures and other financing uses) in net current assets.

Governmental funds use the modified accrual basis of accounting. The modified accrual basis is the accrual basis adapted to the governmental fund-type measurement focus. Under the modified accrual basis of accounting, revenues are recorded when received in cash unless susceptible to accrual. Revenues are susceptible to accrual if they are measurable, available and earned within sixty days after the end of the fiscal year to finance expenditures of the fiscal year. Revenues are unearned if material and received before the normal time of receipt or if received for an activity and the expense for that activity has not been incurred prior to fiscal year-end. Expenditures are recognized when the related fund liability is incurred, with the following exceptions:

- 1) principal and interest on long-term debt are recognized when due;
- 2) prepayments are accounted for as expenditures in the period of acquisition;

- 3) inventory items are considered expenditures when purchased.

The Loans Receivable and Allowance for Loan Forgiveness balances reside in the Special Revenue funds for each program. The net of these balances represents the total amount considered collectible.

### **C. Valuation**

The book value of bonds is the “amortized” cost, which represents the original cost, adjusted for premium and discount amortizations where applicable. If bonds are purchased at more than the par value, the difference is called a premium. If they are purchased for less than par value, then the difference is called a discount. Premiums and discounts are amortized/accreted using the straight-line or scientific method to the call, average life, or maturity date of the securities. If the same investment has been purchased several times, the average of the purchase prices is the book value. All investment portfolios presented on the Combined Balance Sheet are recorded at fair value based on quoted market price.

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

#### **Cash and Cash Equivalent**

Cash and cash equivalents consist of funds deposited with US Bank National Association (US Bank) as trustee, and the State of Montana Treasury and include investments categorized as cash equivalents. Cash equivalents are defined as short-term, highly liquid investments with original maturities of three months or less. Cash and cash equivalents are reported at cost. Cash and cash equivalents, as identified in the Combined Balance Sheet, are as follows (In Thousands):

#### **Held by Trustee:**

First American Government Obligation	\$40,644
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#### **Investments**

An Indenture of Trust specifies the eligible investments meeting defined rating and risk criteria in which the state may invest. The state invests funds through its trustee bank, US Bank.

Eligible investments are limited, generally, to obligations of, or guaranteed as to principal and interest by the United States of America, or by any agency or instrumentality thereof. A primary investment objective is to purchase investments that mature, or are subject to redemption, on or prior to the date or dates that the department anticipates that money will be required to make funds available for loans or to make bond payments.

In accordance with the permitted investments as defined in the Indenture of Trust, the cash equivalent funds, invested at the direction of the issuer and held by US Bank, as trustee, are held in a Treasury Obligations Money Market Fund that invests exclusively in short-term U.S. Treasury obligations and repurchase agreements secured by U.S. Treasury obligations. The U.S. Treasury obligations in which the fund invests include U.S. Treasury bonds, notes, and bills, and are backed

by the full faith and credit of the United States government.

The short- and long-term investments in the program are held in U.S. Treasury bills and notes. U.S. Treasury bills have maturities of one year or less and U.S. Treasury notes have maturities greater than one year from the date of issuance.

### **Credit Risk**

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization.

The SRF minimizes credit risk by limiting securities and types of investments to the Indenture of Trust. Obligations of the U.S. Government or obligations explicitly guaranteed by the U.S. Government are not considered to have credit risk and do not require disclosure of credit quality per GASB Statement No. 40.

### **Custodial Credit Risk**

Custodial credit risk for investments is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The investment policy as defined in the Indenture of Trust, and contract with the trustee, does not require collateralization for cash and securities held by the trustee. Securities are registered with the Federal Reserve Bank under "U.S. Bank as trustee for the State of Montana Department of Natural Resources and Conservation." As custodian for the First American money market mutual funds, US Bank holds collateral at 101% of cost. Deposits in a money market savings accounts are FDIC insured for up to the current limit of \$250,000.

### **Interest Rate Risk**

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The investment definition for the programs, as specified in the Indenture of Trust, does not explicitly address interest rate risk. However, the investment definition implicitly limits interest rate risks by emphasizing liquidity, holding investments to maturity, and narrowly defining the eligible investments. In general, a shorter average maturity for fixed-income securities held in the money market funds means less sensitivity to interest rate changes. The following table uses effective duration as a measure of interest rate risk for all investment types. (The following table is in Thousands.)

	<b>6/30/2018 Fair Value</b>	<b>Moody's Rating</b>	<b>Effective Duration</b>
<b>Security Investment Types Held by Trustee</b>			
Federal Home Loan Mortgage Corp	5,282	Aaa	1.75
Federal National Mortgage Assoc.	3,635	Aaa	2.04
US Treasury Note	801	Aaa	0.63
<b>Total All Investments</b>	<b>9,718</b>		

#### **4. Fair Value Measurement**

Investments are measured and recorded using fair value measurement guidelines established by GAAP. These guidelines recognize a three-tier fair value hierarchy, as follows:

- Level 1: Quoted prices for identical investments in active markets;
- Level 2: Prices determined using inputs, other than quoted prices included within Level 1, that are observable for an asset or liability, either directly or indirectly; and
- Level 3: Unobservable inputs.

At June 30, 2018, SRF had the following recurring fair value measurements (In Thousands):

		<b>Fair Value Measurements Using</b>		
		<b>Quoted Prices in Active Markets for Identical Assets</b>	<b>Significant Other Observable Inputs</b>	<b>Significant Unobservable Inputs</b>
	<b>6/30/2018</b>	<b>(Level 1)</b>	<b>(Level 2)</b>	<b>(Level 3)</b>
<b><u>Investments by fair value level</u></b>				
US Treasury	801	800		
US Agencies	8,917		8,917	
<b>Total Investments at Fair Value</b>	<b>9,718</b>	<b>800</b>	<b>8,917</b>	

#### **5. Loans Receivable**

Montana operates both SRF programs as direct loan programs. Most loans made to communities through the WPCSRF program are funded 83.33 percent by federal EPA capitalization grants, and 16.67 percent by state match. The WPCSRF program also made recycled loans that were disbursed from loan repayment funds. Most loans made by the DWSRF program are funded 80 percent by federal EPA capitalization grants and 20 percent by state match. The DWSRF program also made recycled loans that were disbursed from loan repayment funds. Loan funds are disbursed to the local borrower agencies by the trustee bank as the local borrower agencies expend funds for the purposes of the loan and request reimbursement from the program. Interest is calculated from the date that funds are disbursed. Typically, after the final disbursement has been made, the payment schedule is certified in the loan agreement and adjusted for the actual amounts disbursed. No provision for uncollectible accounts has been made as all loans are current in terms of compliance

with the repayment schedules, and management believes that all loans will be repaid according to the terms of the loan agreements.

The EPA federal funds for capitalization grant loans issued during SFY 2018 have a loan forgiveness component. If the community meets certain requirements, a portion of the loan is forgiven. The State of Montana recorded the forgivable loans in a federal special revenue fund as Loans Receivable with an offset to Allowance for Loan Forgiveness. When a community has met the requirements, the loan receivable and allowance balances are zeroed out. During SFY 2018, the program forgave \$559,000 in loans in the WPCSRF and \$1,035,590 in loans for the DWSRF programs.

The drawn and outstanding principal balance of all loans guaranteed by the WPCSRF program as of June 30, 2018, is \$282,471,513 with an allowance for loan forgiveness of \$5,566,730 resulting in a net loans outstanding balance of \$276,904,783 which includes \$4,292,500 presented as advances to other funds. The advances are inter-fund loans within the DNRC used for the non-point source private loans program.

The drawn and outstanding principal balance of all loans guaranteed by the DWSRF program as of June 30, 2018, is \$165,506,358 with an allowance for loan forgiveness of \$5,171,706 resulting in a net loans receivable balance of \$160,334,652.

Loans mature at various intervals through July 1, 2048. The scheduled principal payments on loans and advances to other funds maturing in the years following SFY 2018 are as follows:

<b><u>SFY ending June 30:</u></b>	<b><u>WPCSRF Amount</u></b>	<b><u>DWSRF Amount</u></b>
2019	\$ 14,408,014	\$ 9,562,335
2020	20,172,400	11,832,000
2021	20,436,996	11,945,025
2022	20,089,100	11,667,561
2023 and thereafter	<u>201,798,273</u>	<u>115,327,731</u>
<b>Total</b>	<b>\$ 276,904,783</b>	<b>\$ 160,334,652</b>

As of June 30, 2018, the WPCSRF and DWSRF programs had authorized loans to public entities of the State of Montana that in the aggregate exceeded \$593.4 and \$320.6 million, respectively. The outstanding balances of the largest loans in each portfolio are as follows:

<b><u>Water Pollution Control State Revolving Fund</u></b>		
<b><u>Local Agency</u></b>	<b><u>Authorized Loan Amount</u></b>	<b><u>Outstanding Balance</u></b>
City of Glendive	\$ 16,226,870	\$ 15,480,000
City of Kalispell	14,470,000	8,615,000
City of Great Falls	11,295,267	2,290,000
City of Havre*	10,437,710	9,391,000

Butte-Silverbow County III*	10,268,000	9,357,576
Butte-Silverbow County I	10,000,000	8,945,000
Butte-Silverbow County II	10,000,000	9,101,000
City of Bozeman	9,573,000	6,870,000
City of Bozeman	9,500,000	6,432,000
City of Helena	9,320,000	2,590,000
<b>Total</b>	<b>\$ 111,090,847</b>	<b>\$ 79,071,576</b>

**Drinking Water State Revolving Fund**

<b><u>Local Agency</u></b>	<b><u>Authorized Loan Amount</u></b>	<b><u>Outstanding Balance</u></b>
City of Billings II	\$ 17,300,000	\$7,737,000
City of Bozeman A	10,000,000	7,638,000
City of Great Falls A	10,000,000	9,241,000
City of Great Falls B	10,000,000	9,609,000
City of Bozeman B	9,552,000	7,687,000
City of Great Falls C*	8,600,000	3,466,577
City of Havre II	8,401,000	2,947,000
City of Bozeman*	7,573,000	4,356,497
City of Billings III	6,759,215	4,356,000
City of Billings VI	6,100,000	5,277,000
<b>TOTAL</b>	<b>\$94,285,215</b>	<b>\$62,315,074</b>

\* Still drawing funds.

**6. Interest Receivable on Loans**

The interest receivable on loans represents interest owed by borrowers as of June 30, 2018, for the July 1, 2018, payment. It represents the six months of interest accrued from the previous loan payment date of January 1, 2018. Interest receivable balances in the WPCSRF include \$282,682 in the Special Administration fund and \$1,155,304 in the Debt Service and Loan Loss Reserve funds. Interest receivable in the DWSRF includes \$283,942 in the Special Administration fund and \$958,973 in the Debt Service and Loan Loss Reserve funds. Interest receivable does not include interest payments received through June 30, 2018, that were due July 1, 2018. Interest payments received through June 30, 2018, amounted to \$2,256,036 for the WPCSRF and \$806,819 for the DWSRF.

**7. Short-term Debt**

The state may issue notes in anticipation of a Bond issuance. During the SFY 2018, two bond anticipation notes (BANs) were issued. The proceeds of Wastewater 2017B and Drinking Water

2017C will be used to fund water and wastewater improvements and rehabilitation.

The following schedule summarized the activity for the year ended June 30, 2018:

<b>BANS</b>	<b>Begin Bal</b>	<b>Additions</b>	<b>Reductions</b>	<b>Ending Bal</b>
Drinking Water-2015B	1,540,000	1,000,000	2,190,000	350,000
Wastewater-2016C	825,000	1,000,000	1,825,000	-
Wastewater-2017B <sup>1</sup>	-	1,900,000	1,450,000	450,000
Drinking Water-2017C <sup>2</sup>	-	900,000	-	900,000

<sup>1</sup> WW 2017B has not been fully drawn. Balance yet to draw \$1,050,000.

<sup>2</sup> DW 2017C has not been fully drawn. Balance yet to draw \$1,600,000.

## 8. Bonds Payable

WPCSRF general obligation bonds payable at June 30, 2018, were as follows:

### Series 2013E

<b>Payable during the year ending June 30,</b>	<b>Interest Range (%)</b>	<b>Principal</b>	<b>Interest</b>	<b>Total</b>
2019	2%-4%	810,000	81,650	891,650
2020		480,000	64,800	544,800
2021		480,000	50,400	530,400
2022		480,000	36,000	516,000
2023		480,000	21,600	501,600
2024		480,000	7,200	487,200
<b>Total Cash Requirements</b>		<b>\$ 3,210,000</b>	<b>\$ 261,650</b>	<b>\$ 3,471,650</b>

### Series 2015C

<b>Payable during the year ending June 30,</b>	<b>Interest Range (%)</b>	<b>Principal</b>	<b>Interest</b>	<b>Total</b>
2019	3%-5%	835,000	1,101,700	1,936,700
2020		870,000	1,067,600	1,937,600
2021		905,000	1,032,100	1,937,100
2022		940,000	990,500	1,930,500
2023		985,000	942,375	1,927,375
2024-2028		5,725,000	3,901,125	9,626,125
2029-2033		7,310,000	2,279,750	9,589,750
2034-2036		5,320,000	407,500	5,727,500
<b>Total Cash Requirements</b>		<b>\$ 22,890,000</b>	<b>\$ 11,722,650</b>	<b>\$ 34,612,650</b>

**TOTAL GENERAL OBLIGATION DEBT - WPCSRF****Payable during the year**

<b>ending June 30,</b>	<b>Principal</b>	<b>Interest</b>	<b>Total</b>
2019	1,645,000	1,183,350	2,828,350
2020	1,350,000	1,132,400	2,482,400
2021	1,385,000	1,082,500	2,467,500
2022	1,420,000	1,026,500	2,446,500
2023	1,465,000	963,975	2,428,975
2024-2028	6,205,000	3,908,325	10,113,325
2029-2033	7,310,000	2,279,750	9,589,750
2034-2036	5,320,000	407,500	5,727,500
<b>Total Cash Requirements</b>	<b>\$ 26,100,000</b>	<b>\$ 11,984,300</b>	<b>\$ 38,084,300</b>

DWSRF general obligation bonds payable at June 30, 2018, were as follows:

**Series 2010B**

<b>Payable during the year</b>	<b>Interest</b>			
<b>ending June 30,</b>	<b>Range (%)</b>	<b>Principal</b>	<b>Interest</b>	<b>Total</b>
2019	2%-4%	495,000	74,050	569,050
2020		510,000	56,463	566,463
2021		530,000	37,600	567,600
2022		295,000	22,131	317,131
2023		100,000	14,600	114,600
2024-2026		315,000	19,300	334,300
<b>Total Cash Requirements</b>		<b>\$ 2,245,000</b>	<b>\$ 224,144</b>	<b>\$ 2,469,144</b>

DWSRF GO 2005F was paid off early in FY 2018.

**9. Fund Balance**

All of the fund balances in the WPCSRF and DWSRF programs are restricted. The classification of Fund Balance Restricted is used in the SRF program because the use of resources is restricted by parties outside the state, such as EPA and the bond holders.

**10. Program Capitalization**

The WPCSRF and DWSRF programs are capitalized by grants from the EPA and matching funds from the State of Montana. All grant funds drawn are recorded as revenue. As of June 30, 2018, the state match requirement in the WPCSRF program is approximately \$37,500,000 but the state has matched additional funds of approximately \$65,100,000. As of June 30, 2018, the state match



requirement in the DWSRF program is approximately \$51,000,000, but the state has matched additional funds of approximately \$8,400,000.

### 11. Federal Capitalization Grant Revenue

Actual draws of federal funds can differ from the amount of federal capitalization grant revenue reported on the Combined Statement of Revenues, Expenditures and Changes in Fund Balances. This occurs because state accounting policy requires federal special revenue funds reflect a zero fund balance at fiscal year-end (with the exception of "A" accruals). Consequently, at fiscal year-end, if a positive fund balance exists, unearned revenue is recorded and if a negative fund balance exists, an accounts receivable is established and revenue is recorded to zero the fund balance.

The following is a reconciliation of federal revenues reported on the financial statements to federal cash actually drawn during the state fiscal year:

<u>WPCSRF</u>	
<b>Federal Revenue - Combined Statement</b>	<b>\$8,334,701</b>
Adjustment Due From Federal Govt SFY 2017	4,980
Adjustment Due From Federal Govt SFY 2018	(3,521)
Other Adjustments	-
<b>Total Federal Draws</b>	<b>\$8,336,160</b>

<u>DWSRF</u>	
<b>Federal Revenue - Combined Statement</b>	<b>\$9,100,900</b>
Adjustment Due From Federal Govt SFY 2017	78,968
Adjustment Due From Federal Govt SFY 2018	(79,445)
Other Adjustments	-
<b>Total Federal Draws</b>	<b>9,100,423</b>

### 12. Interest Income on Investments

This revenue represents interest earnings on investments within the funds and amortized (premiums) and accreted discounts recognized monthly and at the disposal of government securities. All assets of the funds are fully invested by the trustee, to the degree possible, in investment vehicles. The investments range from U.S. Treasury obligation money market funds to long-term government securities. In some funds, interest income is earned in one fund but transferred to another fund in accordance with terms of the bond indenture.

### 13. Investment Gains/(Losses)

This revenue represents the gain and losses as investments are sold.

### 14. Investment Appreciation/(Depreciation) Income

This revenue represents the appreciation or depreciation of the investments reported from the Cash Value to the Market Value at June 30, 2018.

**15. Interest Income from Loans**

This revenue represents interest earnings from loan repayments made by borrowers. In SFY 2013, the SRF programs offered borrowers who issued revenue and general obligation bonds the chance to restructure their interest rates. Depending upon the term remaining to repay their loans, the new interest rates are between 1.25% and 3% as compared to current rates of 3.75% to 4%. Loans must be in compliance with the program and bond requirements. The total interest rate can be comprised of a percentage for loan interest rate, Loan Loss Reserve surcharge and Special Administration surcharge. For SFY 2018, the interest incomes for each of these components were as follows:

	<u>WPCSRF</u>	<u>DWSRF</u>
Loan Interest	\$ 5,302,088	\$ 2,876,894
Loan Loss Reserve	683,330	314,051
Special Administration	<u>1,385,340</u>	<u>808,130</u>
<b>Total Interest Income</b>	<b>\$ 7,370,758</b>	<b>\$ 3,999,075</b>

**16. Program Administration and Set-Aside Funds**

This expenditure represents costs incurred by DEQ and DNRC to administer the SRF programs. They are reflected in special revenue funds (both federal grant funds and state funds are used). Program Administration appears under the Resource/recreation/environment function in the State of Montana Comprehensive Annual Financial Report (CAFR).

The DWSRF program includes program administration as well as several “sub-programs”, called set-asides, which states can elect. The following details what percentage of capitalization grants a State may use for administration and set-asides:

- up to 4 percent of its grants to administer the DWSRF and provide technical assistance to public water systems;
- up to 2 percent of its grants to provide assistance to small public water systems;
- up to 10 percent of its grants for state program management activities, including administration of the state public water system supervision program, administration of the source water protection program, and development and implementation of the capacity development and operator certification programs;
- up to 15 percent of its grants to assist in the development and implementation of local drinking water protection initiatives and other State programs.

**DWSRF Program Administration/Set-Asides Detail:**

Administration - EPA Grants	\$404,542
Administration - State Funds	596,555
Technical Assistance	30,795
State Program Management	1,105,485

Local Assistance	451,776
<b>Total Administration and Set-Asides</b>	<b><u>\$2,589,153</u></b>

In the WPCSRF program, there are no set-aside funds available.

<b>WPCSRF Program Administration Detail:</b>	
Administration - EPA Grants	\$251,205
Administration - State Funds	<u>945,180</u>
<b>Total Administration</b>	<b><u>\$1,196,385</u></b>

## 17. Other Financing Sources and Uses

The BAN (Intercept) Transfers represent the non-cash transfer from the BAN proceeds State Special Revenue account (fund) to the Debt Service account (fund). This transfer is required to move the BAN (Intercept) liability to the fund that will service the debt.

The Debt Service Sweep represents loan interest amounts received that exceeds the debt service requirements. The balances remaining in Debt Service accounts are transferred to the Investment accounts in State Special Revenue funds. Both funds are required by the SRF program. This occurs after payments are made to the bondholders on January 15 and July 15 of each year. In the Arbitrage Certificate, this activity is termed a Debt Service Sweep.

The Loan Loss Reserve Sweep represents cash in excess of the reserve requirement that is transferred from the Loan Loss Reserve accounts to the Principal and Debt Service accounts per the trust indentures. The Loan Loss Reserve funds are not required by the SRF program, but the state elected to have these funds to account for these transactions separately. These transfers are only visible on the Regulatory Basis Financial Statements. The entries are eliminated on the GAAP Financial Statements.

The Federal Capitalization Grant Transfers represent the transfer of EPA grant funds from federal special revenue funds to the Loan Accounts in state special revenue funds to fund loans that will be repaid. These transfers are only visible on the GAAP Financial Statements. The entries are eliminated on the Regulatory Basis Financial Statements.

The Investment Earnings Transfers represent the transfers of the balances of earnings to various accounts within each SRF program per the trust indenture.

The Investment Fund (Account) Transfers represent the transfers of funds from the Investment accounts to the Principal and Debt Service accounts as needed within each SRF program per the trust indenture.

## 18. Related Party Transaction

Per Title 85, Chapter 1, part 6, MCA, Renewable Resource Grant and Loan Program, the

department is eligible to issue GO bonds for the purpose of making private sale loans. DNRC has applied and received “recycled loan funds” from the SRF program for the non-point source private loan program. The loans are GO private sale bonds. The current loans in repayment have a balance of \$4,292,500, have interest rates ranging from 3% to 4.3% and are repaid over 15 years. These loans are presented as Advances to Other Funds on the balance sheets.

### **19. Prior Period Adjustment**

In SFY 2018, the prior period adjustment in the State Special Revenue and Debt Service funds are due to the reclassification of all BAN activity to the Advance from BAN (Intercap) Payable. The reclassification reverses manual adjustments that had recorded the full amount of the BAN in the Bond/BAN/RAN Proceeds under Other Financing Sources and the BAN payments in the Bond/BAN/RAN Principle under Other Financing Uses, both on the Combined Statement of Revenues, Expenditures, and Changes in Fund Balances, and the balance remaining to draw on the BAN in the Bond Proceeds Receivable on the Combined Balance Sheet.

**MONTANA WATER POLLUTION CONTROL AND DRINKING WATER  
SCHEDULE OF REVOLVING AND NON-REVOLVING SRF PROGRAMS  
BALANCE SHEET  
SPECIAL REVENUE AND DEBT SERVICE FUNDS  
REGULATORY BASIS  
JUNE 30, 2018**

ASSETS	WATER POLLUTION CONTROL SPECIAL REVENUE		WATER POLLUTION CONTROL DEBT SERVICE FUND		DRINKING WATER SPECIAL REVENUE		DRINKING WATER DEBT SERVICE FUND		(MEMORANDUM ONLY) TOTAL
	REVOLVING FUND	NON REVOLVING FUND	REVOLVING FUND	NON REVOLVING FUND	REVOLVING FUND	NON REVOLVING FUND	REVOLVING FUND	NON REVOLVING FUND	
Cash and Cash Equivalents	\$23,015,675	\$1,753,399	\$1,662,104	\$2,739,123	\$8,991,581	\$1,480,843	\$384,741	\$617,424	40,644,890
Interest Receivable on Loans		282,692	1,033,418	121,887		283,942	848,055	110,918	2,680,902
Due from Federal Government	3,521				79,445				82,966
Investments					9,717,358				9,717,358
Loans Receivable	\$278,179,013				\$165,506,358				432,946,935
Less Allowance for Loan Forgiveness	(5,566,730)	272,612,283			(5,171,706)	160,334,652			4,292,500
Advances to Other Funds	4,292,500								2,522
Prepaid Expense					2,522				
<b>Total Assets</b>	<b>\$299,923,979</b>	<b>\$2,036,081</b>	<b>\$2,695,522</b>	<b>\$2,861,009</b>	<b>\$179,125,558</b>	<b>\$1,764,786</b>	<b>\$1,232,797</b>	<b>\$728,342</b>	<b>490,368,074</b>
<b>LIABILITIES AND FUND BALANCES</b>									
<b>Liabilities:</b>									
Accounts Payable		\$642			\$310				952
Loans Payable	\$755	17,000			21,500	\$15,000			54,255
Vouchers Payable	104	8,585			4,171	32			12,893
Payroll Payable	3,346	33,336			55,752	32,578			125,012
Due to Other BU or Fund			\$2,192				\$33,248		35,440
Unearned Revenue	27				316				343
Advance from BAN (Intercep) Payable			450,000				1,250,000		1,700,000
<b>Total Liabilities</b>	<b>\$4,232</b>	<b>\$59,564</b>	<b>\$452,192</b>	<b>\$0</b>	<b>\$82,049</b>	<b>\$47,611</b>	<b>\$1,283,248</b>	<b>\$0</b>	<b>\$1,928,895</b>
<b>Fund Balances</b>									
Fund Balance-Restricted	299,919,747	1,976,517	2,243,330	2,861,009	179,043,509	1,717,175	(50,451)	728,342	488,439,179
<b>Total Liabilities and Fund Balances</b>	<b>\$299,923,979</b>	<b>\$2,036,081</b>	<b>\$2,695,522</b>	<b>\$2,861,009</b>	<b>\$179,125,558</b>	<b>\$1,764,786</b>	<b>\$1,232,797</b>	<b>\$728,342</b>	<b>\$490,368,074</b>

This schedule is prepared on a regulatory basis of presentation, rather than a GAAP (1) basis, as requested by the Environmental Protection Agency (EPA) for the Water Pollution Control and Drinking Water State Revolving Fund (SRF) Programs. This presentation separates certain regulated Revolving Fund (within the Fund) and Non-Revolving Fund (outside the Fund) activity by fund type. All proceeds from the EPA Capitalization Grant, corresponding state matching funds, and loan principal and interest repayments must be deposited into the Revolving Fund under Title VI of the Clean Water Act and Title XIV of the Safe Drinking Water Act. Other proceeds, including Administration and Origination Fees and Loan Loss Reserves are deposited into the Non-Revolving Fund and may be used for other water quality purposes under the federal acts mentioned above.

(1) Generally Accepted Accounting Principles (GAAP).

**MONTANA WATER POLLUTION CONTROL AND DRINKING WATER  
SCHEDULE OF REVOLVING AND NON-REVOLVING SRF PROGRAM  
REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES  
SPECIAL REVENUE AND DEBT SERVICE FUNDS  
REGULATORY BASIS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2018**

	WATER POLLUTION CONTROL SPECIAL REVENUE		WATER POLLUTION CONTROL DEBT SERVICE FUND		DRINKING WATER SPECIAL REVENUE		DRINKING WATER DEBT SERVICE FUND		(MEMORANDUM ONLY) TOTAL
	REVOLVING FUND	NON REVOLVING FUND	REVOLVING FUND	NON REVOLVING FUND	REVOLVING FUND	NON REVOLVING FUND	REVOLVING FUND	NON REVOLVING FUND	
<b>REVENUES:</b>									
Federal Capitalization Grant Revenue	\$8,334,701				\$9,100,900				\$17,435,600
Interest Income on Investments	148,376	\$11,039	\$2,252	\$29,312	251,024	\$11,244	\$5,140	\$5,140	\$459,839
Investment Gain (Losses)				(8,844)	(14,318)				(823,162)
Investment Appr/Depr./Inc	3,331	210	554	554	(105,179)	258			(\$100,826)
Interest Income from Loans		1,385,340	5,302,088	683,330		808,130	2,876,894	314,051	\$11,369,833
Other Income	11				451				\$462
<b>Total Revenues</b>	<b>\$8,486,418</b>	<b>\$1,396,589</b>	<b>\$5,304,340</b>	<b>\$704,353</b>	<b>\$9,232,878</b>	<b>\$819,632</b>	<b>\$2,878,347</b>	<b>\$319,190</b>	<b>\$29,141,747</b>
<b>EXPENDITURES:</b>									
Program Administration/Set-Asides	\$288,075	\$908,310	\$0	\$0	\$1,992,598	\$596,555	\$0	\$0	\$3,785,537
<b>Total Expenditures</b>	<b>\$288,075</b>	<b>\$908,310</b>	<b>\$0</b>	<b>\$0</b>	<b>\$1,992,598</b>	<b>\$596,555</b>	<b>\$0</b>	<b>\$0</b>	<b>\$3,785,537</b>
<b>Excess Revenues Over/(Under) Expenditures</b>	<b>\$8,198,344</b>	<b>\$488,279</b>	<b>\$5,304,340</b>	<b>\$704,353</b>	<b>\$7,240,280</b>	<b>\$223,077</b>	<b>\$2,878,347</b>	<b>\$319,190</b>	<b>\$25,356,209</b>
<b>OTHER FINANCING SOURCES:</b>									
<b>Operating Transfers In:</b>									
BAN (Intercept) Transfers	\$2,900,000				1,900,000				\$226,113
Debt Service Sweeps	83,408				142,705				\$1,316,758
Loan Loss Reserve Sweeps			682,213				\$634,545		\$148,418
Investment Earnings Transfers	21,803		\$16,546		5,140		\$2,500		\$72,500
Investment Account Transfer			10,000				\$801,975		\$1,763,790
<b>Total Other Financing Sources</b>	<b>\$3,005,211</b>	<b>\$0</b>	<b>\$708,759</b>	<b>\$0</b>	<b>\$2,047,845</b>	<b>\$0</b>	<b>\$801,975</b>	<b>\$0</b>	<b>\$1,763,790</b>
<b>OTHER FINANCING USES:</b>									
Bond Principal			\$1,295,000				\$1,295,000		\$2,590,000
Bond/BAN (Intercept) Interest			1,245,607				150,845		\$1,396,452
Loan Forgiveness	\$2,781,280				\$1,849,203				\$4,630,483
<b>Operating Transfers Out:</b>									
BAN (Intercept) Transfer			2,900,000				1,900,000		\$4,800,000
Debt Service Sweeps			83,408				142,705		\$226,113
Loan Loss Reserve Sweeps				682,213			\$634,545		\$1,316,758
Investment Earnings Transfers	16,546		21,803		104,930		5,140		\$148,418
Investment Account Transfer	10,000				62,500				\$72,500
<b>Total Other Financing Uses</b>	<b>\$2,807,806</b>	<b>\$0</b>	<b>\$5,524,015</b>	<b>\$704,016</b>	<b>\$2,016,633</b>	<b>\$0</b>	<b>\$3,488,550</b>	<b>\$639,685</b>	<b>\$15,180,704</b>
<b>Excess (deficiency) of Revenues and Other Financing Sources over (under) Expenditures and Other Financing Uses</b>	<b>8,395,749</b>	<b>\$488,279</b>	<b>\$489,084</b>	<b>\$337</b>	<b>\$7,271,492</b>	<b>\$223,077</b>	<b>\$191,771</b>	<b>(\$320,494)</b>	<b>\$16,739,294</b>
<b>FUND BALANCES JULY 1, 2017</b>	<b>292,523,998</b>	<b>1,488,238</b>	<b>2,581,419</b>	<b>2,860,672</b>	<b>172,772,017</b>	<b>1,494,098</b>	<b>1,340,689</b>	<b>1,048,836</b>	<b>476,109,968</b>
<b>PRIOR YEAR ADJUSTMENTS</b>	<b>(1,000,000)</b>	<b>(827,173)</b>	<b>(827,173)</b>	<b>(1,000,000)</b>	<b>(1,000,000)</b>	<b>(1,582,911)</b>	<b>(1,582,911)</b>	<b>(4,410,084)</b>	<b>\$468,439,178</b>
<b>FUND BALANCES JUNE 30, 2018</b>	<b>\$291,523,998</b>	<b>\$661,065</b>	<b>\$1,754,246</b>	<b>\$1,860,672</b>	<b>\$171,772,017</b>	<b>\$491,188</b>	<b>(241,232)</b>	<b>(534,075)</b>	<b>\$471,579,084</b>

This schedule is prepared on a regulatory basis of presentation, rather than a GAAP (1) basis, as requested by the Environmental Protection Agency (EPA) for the Water Pollution Control and Drinking Water State Revolving Fund (SRF) Programs. This presentation separates certain regulated Revolving Fund (within the Fund) and Non-Revolving Fund (outside the Fund) activity by fund type. All proceeds from the EPA Capitalization Grant, corresponding state matching funds, and loan principal and interest repayments must be deposited into the Revolving Fund under Title VI of the Clean Water Act and Title XIV of the Safe Drinking Water Act. Other proceeds, including Administration and Origination Fees and Loan Loss Reserves are deposited into the Non-Revolving Fund and may be used for other water quality purposes under the federal acts mentioned above.

(1) Generally Accepted Accounting Principles (GAAP).



# Report on Internal Control and Compliance





# LEGISLATIVE AUDIT DIVISION

B-1

Angus Maciver, Legislative Auditor  
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors:  
Cindy Jorgenson  
Joe Murray

## 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

The Legislative Audit Committee  
of the Montana State Legislature:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Montana Water Pollution Control and Drinking Water State Revolving Fund Programs (programs), as of and for the year ended June 30, 2018, and the related notes to the financial statements, which collectively comprise the programs' basic financial statements, and have issued our report thereon dated February 15, 2019.

### *Internal Control Over Financial Reporting*

In planning and performing our audit of the financial statements, we considered the programs' internal control over financial reporting to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the programs' internal control. Accordingly, we do not express an opinion on the effectiveness of the programs' internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal controls was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify

any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

*Compliance and Other Matters*

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

*Purpose of this Report*

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

Respectfully submitted,

*/s/ Cindy Jorgenson*

Cindy Jorgenson, CPA  
Deputy Legislative Auditor  
Helena, MT

February 15, 2019

DEPARTMENT OF  
ENVIRONMENTAL QUALITY

DEPARTMENT OF  
NATURAL RESOURCES  
AND CONSERVATION

DEPARTMENTS' RESPONSE



DEPARTMENT OF NATURAL RESOURCES  
AND CONSERVATION



STEVE BULLOCK, GOVERNOR

1539 ELEVENTH AVENUE

STATE OF MONTANA

DIRECTOR'S OFFICE (406) 444-2074  
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PO BOX 201601  
HELENA, MONTANA 59620-1601

March 11, 2019

Angus Maciver  
Legislative Auditor  
Legislative Audit Division  
PO Box 201705  
Helena, MT 59620-1705

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MAR 14 2019  
LEGISLATIVE AUDIT DIV.

Dear Mr. Maciver:

We have received and reviewed the financial audit of the Montana Water Pollution Control and Drinking Water State Revolving Fund Programs for the fiscal year ended June 30, 2018. We are pleased with the unqualified opinion and wish to thank your staff for the professionalism and courtesy with which the audit was conducted.

Sincerely,

John E. Tubbs  
Director, DNRC

Patricia Greiberis  
Chief Financial Officer, DNRC

Shaun McGrath  
Director, DEQ

Brenda Thomas  
Chief Financial Officer, DEQ