

**State of Illinois
ENVIRONMENTAL PROTECTION AGENCY
FUND 270 - WATER REVOLVING FUND**

**FINANCIAL AUDIT
For the year ended June 30, 2005**

**Performed as Special Assistant Auditors
For the Auditor General, State of Illinois**

STATE OF ILLINOIS
ENVIRONMENTAL PROTECTION AGENCY
FUND 270 - WATER REVOLVING FUND

FINANCIAL AUDIT
For the Year Ended June 30, 2005

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**STATE OF ILLINOIS
ENVIRONMENTAL PROTECTION AGENCY
FUND 270 - WATER REVOLVING FUND
YEAR ENDED JUNE 30, 2005**

AGENCY OFFICIALS

Director	Douglas P. Scott
Deputy Director- Environmental Operations and Administration	Bernard P. Killian
Deputy Director- Pollution Prevention and Legal	Ron Burke
Bureau Chief Bureau of Water	Marcia Willhite
Finance- Division of Administration	Willa Barger
Chief Legal Counsel	Robert A. Messina

Agency offices are located at:

1021 North Grand Avenue East
Springfield, Illinois 62702

**STATE OF ILLINOIS
ENVIRONMENTAL PROTECTION AGENCY
FUND 270 - WATER REVOLVING FUND
YEAR ENDED JUNE 30, 2005**

FINANCIAL STATEMENT REPORT

SUMMARY

The audit of the accompanying individual nonshared proprietary financial statements of the Water Revolving Fund of the State of Illinois, Environmental Protection Agency was performed by Crowe Chizek and Company LLC.

Based on their audit, the auditors expressed an unqualified opinion on the Agency's individual nonshared proprietary financial statements of the Water Revolving Fund.



Crowe Chizek and Company LLC
Member Horwath International

INDEPENDENT AUDITORS' REPORT

Honorable William G. Holland
Auditor General
State of Illinois

As Special Assistant Auditors for the Auditor General, we have audited the accompanying financial statements of the Water Revolving Fund of the State of Illinois, Environmental Protection Agency, as of and for the year ended June 30, 2005, as listed in the Table of Contents. These financial statements are the responsibility of the State of Illinois, Environmental Protection Agency's management. Our responsibility is to express an opinion on these financial statements based on our audit.

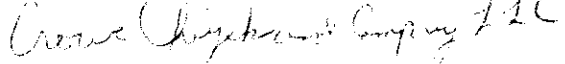
We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and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

As discussed in Note 2, the financial statements present only the Water Revolving Fund and do not purport to, and do not, present fairly the financial position of the State of Illinois, Environmental Protection Agency as of June 30, 2005, and its changes in financial position including cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Water Revolving Fund of the State of Illinois, Environmental Protection Agency, as of June 30, 2005, and the changes in financial position and cash flows, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated October 28, 2005, on our consideration of the State of Illinois, Environmental Protection Agency's internal control over financial reporting of the Water Revolving Fund and on our tests of the State of Illinois, Environmental Protection Agency's 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

This report is intended solely for the information and use of the Auditor General, the General Assembly, the Legislative Audit Commission, the Governor, the Comptroller, and agency management, and is not intended to be and should not be used by anyone other than these specified parties.


Crowe Chizek and Company LLC

Oak Brook, Illinois
October 28, 2005

STATE OF ILLINOIS
ENVIRONMENTAL PROTECTION AGENCY
FUND 270 - WATER REVLOVING FUND
INDIVIDUAL NONSHARED PROPRIETARY FUND

STATEMENT OF NET ASSETS

JUNE 30, 2005
(amounts in \$000's)

	<u>Water Revolving Fund (270 Fund)</u>
ASSETS	
Current assets	
Cash and cash equivalents	\$ 391,162
Short Term Investments	71,083
Loan support receivable and accrued interest on loans	43,743
Loans receivable, net	59,845
Due from federal government	3,878
Restricted assets - pledged loans receivable	<u>34,245</u>
Total current assets	<u>603,956</u>
Noncurrent assets	
Long Term Investments	57,797
Loans and notes receivable, net long-term	919,740
Capital assets being depreciated, net	35
Unamortized bond issuance costs	1,241
Restricted assets - pledged loans receivable	<u>431,110</u>
Total noncurrent assets	<u>1,409,923</u>
Total assets	<u>2,013,879</u>
LIABILITIES	
Current liabilities	
Accounts payable and accrued liabilities	4,357
Due to other funds	72
Current portion of long-term obligations	18,105
Compensated absences, current	<u>461</u>
Total current liabilities	<u>22,995</u>
Noncurrent liabilities	
Noncurrent portion of long-term obligations	248,435
Compensated absences, long-term	<u>688</u>
Total noncurrent liabilities	<u>249,123</u>
Total liabilities	<u>272,118</u>
NET ASSETS	
Invested in capital assets	35
Restricted for	
Debt service	127,245
Other purposes	1,457,652
Unrestricted	<u>156,829</u>
Total net assets	<u>\$ 1,741,761</u>

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

STATE OF ILLINOIS
ENVIRONMENTAL PROTECTION AGENCY
FUND 270 - WATER REVLOVING FUND
INDIVIDUAL NONSHARED PROPRIETARY FUND

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

FOR THE YEAR ENDED JUNE 30, 2005
(amounts in \$000's)

	<u>Water Revolving Fund (Fund 270)</u>
OPERATING REVENUES	
Interest income on loans	\$ 31,015
Interest income on funds with State Treasurer	8,103
Loan support income	<u>10,715</u>
Total operating revenues	<u>49,833</u>
OPERATING EXPENSES	
General and administrative	11,855
Depreciation	<u>42</u>
Total operating expenses	<u>11,897</u>
Operating income	<u>37,936</u>
NONOPERATING REVENUES (EXPENSES)	
Interest and investment income	6,169
Other - grant revenues	60,640
Interest	(12,042)
Other nonoperating expenses	<u>(49)</u>
Total nonoperating revenues (expenses)	54,718
Income before transfers	92,654
Transfers from other funds	4,830
Transfers to other funds	<u>(8)</u>
Change in net assets	97,476
Total net assets, July 1, 2004	<u>1,644,285</u>
Total net assets, June 30, 2005	<u>\$ 1,741,761</u>

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

STATE OF ILLINOIS
ENVIRONMENTAL PROTECTION AGENCY
FUND 270 - WATER REVOLVING FUND
INDIVIDUAL NONSHARED PROPRIETARY FUND

STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED JUNE 30, 2005

(amounts in \$000's)

	<u>Water Revolving Fund (270 Fund)</u>
Cash Flows From Operating Activities	
Cash receipts from interest income on loans	\$ 43,053
Cash payments to employees for services	(10,733)
Other payments	<u>(1,729)</u>
Net cash provided by operating activities	<u>30,591</u>
Cash Flows From Noncapital Financing Activities	
Operating grants received	78,006
Net transfers from other funds	4,822
Interest and principal paid on borrowing	(26,160)
Proceeds from borrowing, net of bond issuance costs	(391)
Trustee fees	<u>(16)</u>
Net cash provided by noncapital financing activities	<u>56,261</u>
Cash Flows From Investing Activities	
Proceeds from sales and maturities of investment securities	362,205
Purchase of investment securities	(350,363)
Loan Disbursements	(153,068)
Loan Repayments	74,192
Interest and investment income	<u>5,489</u>
Net cash used by investing activities	<u>(61,545)</u>
Net increase in cash and cash equivalents	25,307
Cash and cash equivalents, July 1, 2004	<u>365,855</u>
Cash and cash equivalents, June 30, 2005	<u>\$ 391,162</u>
Reconciliation of operating income to net cash provided by operating activities	
Operating income	\$ 37,936
Adjustments to reconcile operating income to net cash provided by operating activities	
Depreciation expense	42
Change in assets and liabilities	
Increase in receivables, net	(6,763)
Decrease in accounts payable and accrued liabilities	(51)
Increase in intergovernmental payables	(37)
Decrease in due to other funds	4
Increase in due to component units	(145)
Increase in other liabilities	<u>(395)</u>
Net cash provided by operating activities	<u>\$ 30,591</u>

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

**STATE OF ILLINOIS
ENVIRONMENTAL PROTECTION AGENCY
FUND 270 - WATER REVOLVING FUND**

**NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005**

NOTE 1 - DESCRIPTION OF FUNDS

The Environmental Protection Agency (the Agency) administers the nonshared proprietary fund described below. A nonshared fund is a fund in which a single State agency is responsible for administering substantially all financial transactions of the fund.

The Water Revolving Fund held by the State Treasurer consists of the Water Pollution Control Loan Program ("Clean Water Program") established under authority granted in the Water Quality Act of 1987, which amended the Clean Water Act of 1972 and the Public Water Supply Loan Program ("Drinking Water Program") established under authority granted in the Federal Safe Drinking Water Act Amendments of 1996.

The Clean Water Program is administered by the Agency pursuant to the Illinois Environmental Protection Act, as supplemented and amended. The Clean Water Program was established as a revolving fund to accept federal capitalization grants, the required 20% State match and any proceeds of revenue bonds for the purpose of making low interest loans to units of local government to finance the construction of wastewater treatment works.

The Drinking Water Program is administered by the Agency pursuant to the Illinois Environmental Protection Act to accept federal capitalization grants, the required 20% State match and any proceeds of revenue bonds for the purpose of making low interest loans to units of local government and certain private community water supplies to finance the construction of public water facilities.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the individual nonshared proprietary fund administered by the Agency have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP), as prescribed by the Governmental Accounting Standards Board (GASB). To facilitate the understanding of data included in the financial statements, summarized below are the significant accounting policies.

Reporting Entity

As defined by GAAP, the financial reporting entity consists of a primary government, as well as its component units, which are legally separate organizations for which the elected officials of the primary government are financially accountable.

(Continued)

STATE OF ILLINOIS
ENVIRONMENTAL PROTECTION AGENCY
FUND 270 - WATER REVOLVING FUND

NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Reporting Entity (Continued)

The individual nonshared proprietary fund is not legally separate from the State of Illinois (State). It is included in the financial statements of the State as a proprietary fund. The State of Illinois' Comprehensive Annual Financial Report may be obtained by writing to the State Comptroller's Office, Financial Reporting Department, 325 West Adams Street, Springfield, Illinois, 62704-1871.

The financial statements present only the Water Revolving Fund (270) administered by the Illinois Environmental Protection Agency and do not purport to, and do not, present fairly the financial position of the Illinois Environmental Protection Agency as of June 30, 2005, and changes in its financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Basis of Presentation

In government, the basic accounting and reporting entity is a fund. A fund is defined as an independent fiscal and accounting entity with a self-balancing set of accounts recording cash and/or other resources together with all related liabilities, obligations, reserves, and equities which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations. A statement of net assets, statement of revenues, expenses, and changes in fund net assets and statement of cash flows have been presented for the individual nonshared proprietary fund administered by the Agency.

Operating revenues consist mainly of interest on loans, which is the principal activity of the fund. Operating expenses consist of administrative activities, depreciation and other expenses. Nonoperating revenues, such as subsidies and non-loan investment earnings, result from nonexchange transactions or ancillary activities

Basis of Accounting

The individual nonshared proprietary fund is reported using the economic resources measurement focus and the accrual basis of accounting.

Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flow takes place. Nonexchange transactions, in which the Agency gives (or receives) value without directly receiving (or giving) equal value in exchange, include grants and entitlements. Revenue from grants, entitlements, and similar items is recognized in the fiscal year in which all eligibility requirements imposed by the provider have been met.

(Continued)

STATE OF ILLINOIS
ENVIRONMENTAL PROTECTION AGENCY
FUND 270 - WATER REVOLVING FUND

NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Basis of Accounting (Continued)

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the individual nonshared proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. The State also has the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The State has elected not to follow subsequent private-sector guidance for the individual nonshared proprietary fund administered by the Agency.

Cash and Cash Equivalents

Cash and cash equivalents consist principally of deposits held in the State Treasury. Cash and cash equivalents also include cash in banks for locally-held funds. Certain investments maturing within a short term, typically three months or less (including U.S. Treasury Bills) are treated as cash and cash equivalents.

Interfund Transactions

The individual nonshared proprietary fund has the following types of interfund transactions with other funds of the State:

Loans - amounts provided with a requirement for repayment. Interfund loans are reported as interfund receivables (i.e., due from other funds) in lender funds and interfund payables (i.e., due to other funds) in borrower funds.

Services provided and used - sales and purchases of goods and services between funds for a price approximating their external exchange value. Interfund services provided and used are reported as revenues in seller funds and expenditures or expenses in purchaser funds. Unpaid amounts are reported as interfund receivables and payables in the fund statement of net assets.

Reimbursements - repayments from the funds responsible for particular expenditures or expenses to the funds that initially paid for them. Reimbursements are reported as expenditures in the reimbursing fund and as a reduction of expenditures in the reimbursed fund.

Transfers - flows of assets (such as cash or goods) without equivalent flows of assets in return and without a requirement for repayment. Transfers are reported after nonoperating revenues and expenses.

(Continued)

STATE OF ILLINOIS
ENVIRONMENTAL PROTECTION AGENCY
FUND 270 - WATER REVOLVING FUND

NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Capital Assets

Capital assets, which includes equipment, are reported at cost. Contributed assets are reported at estimated fair value at the time received. Capital assets are depreciated using the straight-line method.

The capitalization threshold and the estimated useful lives are as follows:

Capital Asset Category	Capitalization Threshold	Estimated Useful Life
Equipment	\$ 5,000	3-25

Compensated Absences

The liability for compensated absences reported in the individual nonshared proprietary fund consists of unpaid, accumulated vacation and sick leave balances for Agency employees. The liability has been calculated using the vesting method, in which leave amounts for both employees who currently are eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination are included. The liability has been calculated based on the employees' current salary level and includes salary-related costs (e.g., social security and Medicare tax).

Legislation that became effective January 1, 1998, capped the paid sick leave for all State Employees' Retirement System members at December 31, 1997. Employees continue to accrue 12 sick days per year but will not receive monetary compensation for any additional time earned after December 31, 1997. Sick days earned between 1984 and December 31, 1997, (with a 50% cash value) would only be used after all days with no cash value are depleted. Any sick days earned and unused after December 31, 1997, will be converted to service time for purposes of calculating employee pension benefits.

Bond Premiums, Discounts and Issuance Costs

Bond premiums and discounts, as well as issuance costs are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as a component of noncurrent assets and are amortized over the term of the related debt.

(Continued)

STATE OF ILLINOIS
ENVIRONMENTAL PROTECTION AGENCY
FUND 270 - WATER REVOLVING FUND

NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Net Assets

Net Assets is displayed in three components as follows:

Invested in Capital Assets - This consists of capital assets, net of accumulated depreciation.

Restricted - This consists of net assets that are legally restricted by outside parties or by law through constitutional provisions or enabling legislation. When both restricted and unrestricted resources are available for use, generally it is the State's policy to use restricted resources first, and then unrestricted resources when they are needed.

Unrestricted - This consists of net assets that do not meet the definition of "restricted" or "invested in capital assets."

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Restricted Assets - Loans Receivable

Under the bond agreements, the repayments of certain loans to municipalities and water districts are pledged against the bond payments. The repayments of those loans are collected in a separate trust account and are used to make bond payments.

NOTE 3 - DEPOSITS AND INVESTMENTS

Deposits

The State Treasurer is the custodian of the State's cash and cash equivalents for funds maintained in the State Treasury. The Agency independently manages cash and cash equivalents maintained outside the State Treasury in money market and checking accounts.

Deposits in the custody of the State Treasurer (or in transit) at June 30, 2005, (expressed in thousands) were \$370,451 (expressed in thousands). Deposits in the custody of the State Treasurer are pooled and invested with other State funds in accordance with the Deposit of State Moneys Act of the Illinois Compiled Statutes (15 ILCS 520/11). Funds held by the State Treasurer have not been categorized as to credit risk because the Agency does not own individual securities. Details on the nature of these investments are available within the State of Illinois' Comprehensive Annual Financial Report.

(Continued)

**STATE OF ILLINOIS
ENVIRONMENTAL PROTECTION AGENCY
FUND 270 - WATER REVOLVING FUND**

**NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005**

NOTE 3 - DEPOSITS AND INVESTMENTS (Continued)

Deposits (Continued)

Custodial credit risk is the risk that, in the event of a bank failure, the Agency's deposits might not be recovered. The Agency does not have a deposit policy for custodial credit risk. As of June 30, 2005, none of the bank balances of \$11,349 (expressed in thousands) were exposed to custodial credit risk.

Investments

At June 30, 2005, the Agency had the following investments and maturities (expressed in thousands):

<u>Investment Type</u>	<u>Fair Value</u>	<u>Investment Maturities (In Years)</u>				<u>Weighted Average Maturity</u>
		<u>Less Than 1</u>	<u>1-5</u>	<u>6-10</u>	<u>More Than 10</u>	
U.S. Treasury Bills	\$ 10,969	\$ 10,969	\$ -	\$ -	\$ -	0.13
U.S. Treasury Notes	1,594	1,594	-	-	-	0.13
State and Local						
Government Series	62,224	4,427	19,491	23,917	14,389	6.53
Commercial Paper	<u>63,455</u>	<u>63,455</u>	<u>-</u>	<u>-</u>	<u>-</u>	0.04
Total	\$ 138,242	\$ 80,445	\$ 19,491	\$ 23,917	\$ 14,389	2.97

Interest Rate Risk. The Public Funds Investment Act (30 ILCS 235/1 et seq.)(the Act) limits investments in corporate debt to maturities of not later than 180 days from the date of purchase. There are no limits on U.S. Treasury or U.S. Agency investments. The Illinois Environmental Protection Agency does not have any additional policies related to interest rate risk.

Credit Risk. The Act limits investments in corporate debt to corporations organized in the United States with assets exceeding \$500,000,000 and to the top three highest classifications established by at least two standards rating services. The Agency's commercial paper investments at June 30, 2005, are rated A-1+ by Standard & Poor's and P-1 by Moody's Investors Service.

The Act limits investments in money market mutual funds to funds registered under the Investment Company Act of 1940, provided the portfolio of such fund is limited to U.S. Treasuries, U.S. Agencies or repurchases thereof. The money market accounts held with brokers at June 30, 2005, consist of portfolios of U.S. Treasury obligations. The money market accounts are rated AAAM by Standard & Poor's and Aaa by Moody's Investors Service.

(Continued)

STATE OF ILLINOIS
ENVIRONMENTAL PROTECTION AGENCY
FUND 270 - WATER REVOLVING FUND

NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005

NOTE 3 - DEPOSITS AND INVESTMENTS (Continued)

Investments (Continued)

In addition, since the Series 2002 and Series 2004 bonds are tax-exempt issues, the bond indentures require adherence to Federal tax law, including certain investment restrictions.

Concentration of Credit Risk. The Act limits investment in corporate obligations to no more than one third of the State of Illinois' investments, taken as a whole. The Agency has no further policies related to concentration of credit risk. At June 30, 2005, 45% of the investment balance was held in commercial paper. Of that \$62,221 (expressed in thousands), or 44% of total investments, was invested in the Danske Corporation.

Reconciliation of notes to financial statements (expressed in thousands):

Deposits held by State Treasurer	\$ 370,451
Carrying amount of Agency deposits	11,349
Carrying amount of investments	<u>138,242</u>
Total	<u>\$ 520,042</u>

Cash and cash equivalents per Statement of Net Assets	\$ 391,162
Investments - Current per Statement of Net Assets	71,083
Investments - Noncurrent per Statement of Net Assets	<u>57,797</u>
Total	<u>\$ 520,042</u>

NOTE 4 - GENERAL AND ADMINISTRATIVE COSTS

The Agency is authorized to utilize up to 4% of the total capitalization grants received for administration of the loan program. The Agency has utilized approximately 80% of the funds, which leaves approximately \$ 1.9 million to fund future administration costs associated with the loan program. The capitalization grants for the Clean Water Program have been drawn down in their entirety.

The Agency also charges a loan support fee. This loan support fee is used to defray program expenses, and is collected and deposited into the Water Revolving Fund. This fee cannot exceed 50% of the fixed loan rate.

The Agency is also authorized to use a portion of each capitalization for specific set-asides authorized under Federal Statutes.

(Continued)

**STATE OF ILLINOIS
ENVIRONMENTAL PROTECTION AGENCY
FUND 270 - WATER REVOLVING FUND**

**NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005**

NOTE 4 - GENERAL AND ADMINISTRATIVE COSTS (Continued)

The Administrative Revenues and Expenses (expressed in thousands) reported in the Water Revolving Fund for the year ended June 30, 2005, are as follows:

Revenues	
Administrative grants	\$ 1,300
Loan Support	10,715
Set-asides	<u>52</u>
	<u>12,067</u>
Expenses	
Payroll and insurance	10,025
Other general expenses	<u>1,830</u>
	<u>11,855</u>
Excess revenues over expenses	<u>\$ 212</u>

NOTE 5 - LOANS AND NOTES RECEIVABLE

Loans and notes receivable consist of loans made to local governments for drinking water and wastewater infrastructure programs.

Each loan to a participant for an eligible project from funds in the Clean Water Program or the Drinking Water Program is evidenced by a Loan Agreement. In each Loan Agreement, the IEPA agrees to make a loan in an amount up to the maximum amount provided in the Loan Agreement. Funds are disbursed to a participant only to pay eligible project costs that actually have been incurred by the participant, and the amount of a loan is generally equal to the aggregate of such disbursed amounts, although in certain instances such amount may also include capitalized interest. The actual amounts loaned to participants will generally depend upon the actual progress of construction on the related projects.

Each Loan Agreement specifies a date as of which the Project is required to initiate operation ("Operation Initiation Date"). Amortization of each Loan is required to begin no later than one year from the earlier of the Operation Initiation Date or the date identified in the Loan Agreement as the initiation of loan repayment date ("Initiation of Loan Repayment Date"). The final maturity of each loan is not later than 20 years from the earlier of the Operation Initiation Date or the Initiation of Loan Repayment Date. Each Loan Agreement permits prepayment of all or a portion of the balance of the loan, without premium. Most of the Loan Agreements provide for semiannual principal and interest payments, with the actual dates of repayment varying from Loan Agreement to Loan Agreement, with a few Loan Agreements providing for quarterly or annual principal and interest payments.

(Continued)

STATE OF ILLINOIS
ENVIRONMENTAL PROTECTION AGENCY
FUND 270 - WATER REVOLVING FUND

NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005

NOTE 5 - LOANS AND NOTES RECEIVABLE (Continued)

Fixed Loan Rate

The Agency assigns to each loan a fixed loan rate at the time a loan is made to the participant. The fixed loan rate is comprised of an interest portion and a loan support portion and is computed by using the mean interest rate of the 20-year Tax-Exempt Bonds General Obligation Bond Buyer Index, as published weekly by *The Bond Buyer*, from July 1 to June 30 of the preceding fiscal year rounded to the nearest 100th of a percent and multiplied by 50 percent. There is no maximum, but the minimum fixed loan rate is 2.50% per annum. The interest rates on the loans currently outstanding are between 2.5% to 3.70%.

Security for Loans

Generally, the repayment obligations of each participant will either be (i) secured by the revenues generated by its wastewater or drinking water system or (ii) a general obligation of the participant. The Agency conducts an analysis as part of its loan review process to determine the appropriate security for a loan and upon making such determination, the participant evidences its obligation under the loan agreement and grants the security determined by the Agency by adopting a bond ordinance or resolution or similar authorization in accordance with State law. In certain instances, a participant may issue revenue bonds, general obligation bonds or other obligations, as applicable, to evidence its repayment obligations.

NOTE 6 - INTERFUND BALANCES AND ACTIVITY

Balances Due to/from Other Funds

The following balances (expressed in thousands) at June 30, 2005, represent amounts due to other Agency and State of Illinois funds.

<u>Amount</u>	<u>Description/Purpose</u>
\$ <u>72</u>	Due to Office of the Auditor General representing audit charges
\$ <u>72</u>	

Transfers to/from Other Funds

During the year ended June 30, 2005, \$ 4,830 (expressed in thousands) was transferred from the Anti Pollution Fund for capital projects.

During the year ended June 30, 2005, \$ 8 (expressed in thousands) was transferred to the Efficiency Initiatives Revolving Fund under Executive Order 10.

(Continued)

**STATE OF ILLINOIS
ENVIRONMENTAL PROTECTION AGENCY
FUND 270 - WATER REVOLVING FUND**

**NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005**

NOTE 7 - CAPITAL ASSETS

Capital asset activity (expressed in thousands) for the year ended June 30, 2005, was as follows:

	Balance <u>July 1, 2004</u>	<u>Additions</u>	<u>Deletions</u>	Balance <u>June 30, 2005</u>
Capital assets being depreciated				
Equipment	\$ 503	\$ -	\$ (58)	\$ 445
Less: accumulated depreciation	<u>402</u>	<u>42</u>	<u>(34)</u>	<u>410</u>
Total capital assets being depreciated	<u>\$ 101</u>	<u>\$ (42)</u>	<u>\$ (24)</u>	<u>\$ 35</u>

NOTE 8 - LONG-TERM OBLIGATIONS

Changes in Long-Term Obligations

Changes in long-term obligations (expressed in thousands) for the year ended June 30, 2005, were as follows:

	Balance <u>July 1, 2004</u>	<u>Additions</u>	<u>Deletions</u>	Balance <u>June 30, 2005</u>	Amounts Due Within <u>One Year</u>
Revenue bonds payable	\$ 268,565	\$	\$ (14,075)	\$ 254,490	\$ 16,455
Unamortized premiums	13,643		(1,593)	12,050	1,650
Other long-term obligations					
Compensated absences	<u>1,544</u>	<u>533</u>	<u>(928)</u>	<u>1,149</u>	<u>461</u>
	<u>\$ 283,752</u>	<u>\$ 533</u>	<u>\$ (16,596)</u>	<u>\$ 267,689</u>	<u>\$ 18,566</u>

Revenue Bonds

The Agency issued \$ 150,000 (expressed in thousands) of Illinois Development Finance Authority Revolving Fund Revenue Bonds, Series 2002, in June of 2002. The Agency also issued \$ 130,000 (expressed in thousands) of Illinois Development Finance Authority Revolving Fund Revenue Bonds, Series 2004, in May of 2004. The purpose of the bonds is to provide funds for loan projects in the Water Revolving Fund. The Agency pledges the income derived from repayments of certain loans currently outstanding to pay debt service in the Water Revolving Fund. Principal on the Series 2002 bonds is payable in semi-annual installments ranging from \$ 1,945 to \$ 5,860 on September 1 and March 1 of each year through March 1, 2020. Interest is payable each September 1 and March 1 at rates ranging from 3.25% to 5.50%. Principal on the Series 2004 bonds is payable in semi-annual installments, ranging from \$ 150 to \$ 5,305, beginning on March 1, 2005, and continuing each September 1 and March 1 thereafter through September 1, 2023. Interest is payable each September 1 and March 1 at rates ranging from 3.25% to 5.50%.

(Continued)

**STATE OF ILLINOIS
ENVIRONMENTAL PROTECTION AGENCY
FUND 270 - WATER REVOLVING FUND**

**NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005**

NOTE 8 - LONG-TERM OBLIGATIONS (Continued)

Revenue Bonds (Continued)

Annual debt service requirements to maturity for revenue bonds are as follows (expressed in thousands):

Year Ending June 30	Principal	Interest
2006	\$ 16,455	\$ 12,834
2007	17,155	12,071
2008	17,950	11,203
2009	18,160	10,303
2010	18,940	9,385
2011 - 2015	90,560	32,315
2015 - 2019	66,055	11,138
2020 - 2024	9,215	661
	\$ 254,490	\$ 99,910

NOTE 9 - NET ASSETS

Net assets (expressed in thousands) at June 30, 2004, are restricted for:

USEPA Capitalization Grants	\$ 1,204,222
State match	253,430
Subtotal net assets restricted for other purposes	1,457,652
Debt service	127,245
Total restricted net assets	\$ 1,584,897

USEPA Capitalization Grants and State Match

The Water Revolving Fund was created pursuant to the Clean Water Act and Safe Drinking Water Act and established to provide financial assistance in the form of loans. In order to qualify for Federal Capitalization Grants, the state must pay into the Revolving Fund a matching amount equal to at least 20% of the amount of such grants (State Match). These funds are restricted for the purpose of making low interest loans from the Fund.

Debt Service

Pursuant to the sale of revenue bonds in 2002 and 2004, the IEPA must maintain an amount equal to 50% of the outstanding principal value of the bonds. The Debt Service Reserve is held by Amalgamated Bank of Chicago, trustee for the IEPA. The Debt Service is set aside to make up any deficiencies that may arise on bond payment dates and may not be used for any other purposes until such bonds have matured.

(Continued)

**STATE OF ILLINOIS
ENVIRONMENTAL PROTECTION AGENCY
FUND 270 - WATER REVOLVING FUND**

**NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005**

NOTE 10 - CAPITALIZATION GRANTS

The IEPA has entered into Capitalization Grant Agreements with the USEPA to administer the Waste Water and Drinking Water Programs, jointly the Water Revolving Fund (270). Pursuant to these Capitalization Grant Agreements, \$ 1,033,841 (expressed in thousands) for Waste Water and \$ 233,142 (expressed in thousands) for Drinking Water have been made available to be drawn on the Capital Grant facility at June 30, 2005, with respect to costs in connection with loans made under the Waste Water and Drinking Water Loan Programs.

The remaining Capital Grant Facility as of June 30, 2005, is summarized below:

	<u>Waste Water</u>	<u>Drinking Water</u>	<u>Total</u>
Total Capital Grants	\$ 1,033,841	\$ 233,142	\$ 1,266,983
Less: Cumulative drawdowns	(1,033,841)	(199,585)	(1,233,426)
Capital Grant Facility	\$ -	\$ 33,557	\$ 33,557

NOTE 11 - PENSION PLAN

Substantially all of the Agency's full-time employees who are not eligible for participation in another state-sponsored retirement plan participate in the State Employees' Retirement System (SERS), which is a pension trust fund in the State of Illinois reporting entity. The SERS is a single-employer defined benefit public employee retirement system (PERS) in which State employees participate, except those covered by the State Universities, Teachers', General Assembly, and Judges' Retirement Systems. The financial position and results of operations of the SERS for fiscal year 2005 are included in the State of Illinois' Comprehensive Annual Financial Report (CAFR) for the year ended June 30, 2005. The SERS issues a separate CAFR that may be obtained by writing to the SERS, 2101 South Veterans Parkway, Springfield, Illinois, 62794-9255.

A summary of SERS benefit provisions, changes in benefit provisions, employee eligibility requirements including eligibility for vesting, and the authority under which benefit provisions are established are included as an integral part of the SERS' CAFR. Also included is a discussion of employer and employee obligations to contribute and the authority under which those obligations are established.

The Agency pays employer retirement contributions in the individual nonshared proprietary funds based upon an actuarially determined percentage of their payrolls. For fiscal year 2005, the employer contribution rate was 16.107%. Effective for pay periods beginning after December 31, 1991, the State opted to pay the employee portion of retirement for most State agencies (including the Agency) with employees covered by the State Employees' and Teachers' Retirement Systems. Beginning July 1, 2003, this "pickup" of 4% of the pension was paid by non-bargaining unit employees. The State continues to pay for bargaining unit employees. The pickup is subject to sufficient annual appropriations and those employees covered may vary across employee groups and State agencies.

(Continued)

**STATE OF ILLINOIS
ENVIRONMENTAL PROTECTION AGENCY
FUND 270 - WATER REVOLVING FUND**

**NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2005**

NOTE 12 - POST-EMPLOYMENT BENEFITS

The State provides health, dental and life insurance benefits for certain retirees and their dependents. Substantially all State employees become eligible for post-employment benefits if they eventually become annuitants of one of the State sponsored pension plans. Health and dental benefits include basic benefits for annuitants under the State's self-insurance plan and insurance contracts currently in force. Life insurance benefits are limited to \$ 5,000 per annuitant age 60 and older.

Costs incurred for health, dental, and life insurance for annuitants and their dependents were not separated from benefits provided to active employees and their dependents for the year ended June 30, 2005. However, post-employment costs for the State as a whole for all State agencies/departments for dependent health, dental and life insurance for annuitants and their dependents are disclosed in the Illinois Comprehensive Annual Financial Report for the State. Cost information for retirees by individual fund or State agency is not available. Payments are made on a "pay-as-you-go" basis.

NOTE 13 - COMMITMENTS

The Agency administers a water loan program to local governments as discussed in Note 5 - Loans and Note Receivable. Under the program, municipalities incur expenditures and subsequently request reimbursement. The Agency is aware of approximately \$17,752 (expressed in thousands) in eligible expenditures incurred by municipalities through June 30, 2005, but for which loan funds were not yet disbursed.



Crowe Chizek and Company LLC
Member Horwath International

**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**

Honorable William G. Holland
Auditor General
State of Illinois

As Special Assistant Auditors for the Auditor General, we have audited the Water Revolving Fund of the State of Illinois, Environmental Protection Agency, as of and for the year ended June 30, 2005, and have issued our report thereon dated October 28, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the State of Illinois, Environmental Protection Agency's internal control over financial reporting of the Water Revolving Fund in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the Water Revolving Fund's financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State of Illinois, Environmental Protection Agency's Water Revolving Fund financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. 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*.

This report is intended solely for the information and use of the Auditor General, the General Assembly, the Legislative Audit Commission, the Governor and agency management and is not intended to be and should not be used by anyone other than these specified parties.

Crowe Chizek and Company LLC
Crowe Chizek and Company LLC.

Oak Brook, Illinois
October 28, 2005