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State Auditor & Inspector

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**OKLAHOMA DEPARTMENT OF
ENVIRONMENTAL QUALITY
OKLAHOMA DRINKING WATER
STATE REVOLVING FUND
LOAN PROGRAM**

**FINANCIAL STATEMENTS
AS OF
JUNE 30, 2011 AND 2010
AND INDEPENDENT AUDITOR'S REPORT**

**OKLAHOMA DEPARTMENT OF ENVIRONMENTAL QUALITY
OKLAHOMA DRINKING WATER STATE REVOLVING FUND LOAN PROGRAM**

**ANNUAL FINANCIAL STATEMENTS
FOR THE YEARS ENDED June 30, 2011 and 2010**

TABLE OF CONTENTS

	<u>PAGE</u>
INDEPENDENT AUDITOR'S REPORT	1
MANAGEMENT'S DISCUSSION AND ANALYSIS	3
FINANCIAL STATEMENTS:	
Statements of Net Assets	5
Statements of Revenues, Expenses and Changes In Net Assets	6
Statements of Cash Flows	7
Notes to Financial Statements	8
SUPPLEMENTAL SCHEDULE INFORMATION	
Supplemental Combining Statement of Net Assets Information- By Program Component	23
Supplemental Combining Statement of Revenues, Expenses and Changes in Net Asset Information- By Program Component	24
Supplemental Combining Statement of Cash Flows Information- By Program Component	25



INDEPENDENT AUDITOR'S REPORT

To the Directors of the
Oklahoma Department of Environmental Quality
Oklahoma Drinking Water State Revolving Fund Loan Program

We have audited the accompanying statements of net assets of the Oklahoma Department of Environmental Quality/Oklahoma Drinking Water State Revolving Fund Loan Program (the "Program") as of June 30, 2011 and 2010, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Program's management. Our responsibility is to express an opinion on these financial statements based on our audits.

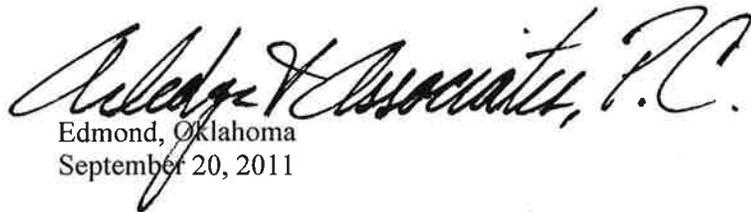
We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Program as of June 30, 2011 and 2010, and the results of its operations and its cash flows for the years 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 our report dated September 20, 2011 on our consideration of the Program's 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 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.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis as listed in the table of contents be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The supplemental combining financial statement information, as listed in the table of contents under Supplemental Schedule Information, is presented for purposes of additional analysis and is not a required part of the basic financial statements of the Program. This 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.


Edmond, Oklahoma
September 20, 2011



STEVEN A. THOMPSON
Executive Director

OKLAHOMA DEPARTMENT OF ENVIRONMENTAL QUALITY

MARY FALLIN
Governor

MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

Our discussion and analysis of the Oklahoma Drinking Water State Revolving Fund Program's (the "Program") financial performance provides an overview of the Program's financial activities for the fiscal year ended June 30, 2011. Please read it in conjunction with the Program's financial statements, which begin on page 5. The Oklahoma Department of Environmental Quality ("ODEQ") administers the Program. ODEQ's primary activities include providing direct assistance and managing the coordination of the Program to meet the objectives of the Safe Drinking Water Act. Pursuant to an interagency agreement between ODEQ and the Oklahoma Water Resources Board (the "OWRB"), OWRB handles certain financial functions including originating, approving and servicing loans made to qualifying recipients.

FINANCIAL HIGHLIGHTS

- The Program's net assets increased by over 8% from \$185,247,818 in FY 2010 to \$201,017,657 in FY 2011. The significant increase can be attributable to an increase in federal grant revenue retained to fund loans.
- The Program experienced an increase of \$94,845,624 in the amount of outstanding loans. At June 30, 2010 the Program had 105 outstanding loans with a principal balance of \$312,789,744. At June 30, 2011 the Program had 112 loans with a balance of \$407,635,368.

PROGRAM HIGHLIGHTS

- During FY 2011, 12 construction and refinancing loan commitments totaling approximately \$70.6 million were made to correct deficiencies and achieve compliance with the national primary drinking water regulations or otherwise further public health protection objectives of the Safe Drinking Water Act (SWDA).
- Completed construction during the year on 11 projects totaling \$67 million.
- Made binding commitments for 12 new loans, totaling approximately \$71.7 million, in drinking water construction for communities to correct problems and achieve compliance with the SWDA.



ECONOMIC FACTORS AND NEXT YEAR'S OUTLOOK

The Oklahoma DWSRF has been extremely popular with communities that borrow from the program. The Program's financing strategy of providing long-term loans at 60% of market rate has been consistent since program start up in 1998. No additional staff is planned at this time. The Program is expected to increase assets as well as operating income as more loans are approved and eligible draws are made from the federal capitalization grants and the bond issue.

CONTACTING THE PROGRAM'S FINANCIAL MANAGEMENT

This financial report is designed to provide the DEQ's accountability of the Program. If you have questions about this report or need additional financial information, contact the Administrative Services Division of the Oklahoma Department of Environmental Quality at 707 North Robinson, Oklahoma City, OK 73101.

**OKLAHOMA DEPARTMENT OF ENVIRONMENTAL QUALITY
OKLAHOMA DRINKING WATER STATE REVOLVING FUND LOAN PROGRAM**

**STATEMENTS OF NET ASSETS
June 30, 2011 and 2010**

<u>ASSETS</u>	<u>2011</u>	<u>2010</u>
Current Assets:		
Cash	\$ 2,465,111	19,224,388
Federal letter of credit payments receivable	627,821	809,002
Accrued interest on loans receivable	3,414,224	2,607,835
Other interest receivable	252,783	337,061
Other receivables	-	75,125
Current portion of loans receivable-		
Small community loans	18,363,401	14,631,091
Large community loans	481,019	562,178
Total current assets	<u>25,604,359</u>	<u>38,246,680</u>
Noncurrent Assets:		
Restricted cash	54,762,776	58,101,634
Restricted investments	63,568,285	73,204,278
Loans receivable, net of current portion and allowance for uncollectible loans of \$492,617 in 2011 and \$209,827 in 2010		
Small community loans	382,621,657	290,946,165
Large community loans	6,169,291	6,650,310
Equipment, net	53,452	96,070
Debt issuance cost, net	2,114,855	1,703,001
Total noncurrent assets	<u>509,290,316</u>	<u>430,701,458</u>
Total assets	<u>534,894,675</u>	<u>468,948,138</u>
	<u>LIABILITIES</u>	
Current Liabilities:		
Accounts payable	130,301	108,792
Due to Oklahoma Department of Environmental Quality ("ODEQ")	509,790	708,342
Compensated absences	35,654	45,049
Interest payable	3,589,219	3,997,215
Current maturities of long-term debt	11,265,000	8,675,000
Total current liabilities	<u>15,529,964</u>	<u>13,534,398</u>
Noncurrent Liabilities:		
Compensated absences	153,650	160,178
Long-term debt, net of current maturities	304,575,000	257,930,000
Unamortized (discount)/ premium	13,618,404	12,075,744
Total noncurrent liabilities	<u>318,347,054</u>	<u>270,165,922</u>
Total liabilities	<u>333,877,018</u>	<u>283,700,320</u>
	<u>NET ASSETS</u>	
Invested in capital assets, net of related debt	53,452	96,070
Restricted for loans and debt service	201,153,509	185,356,975
Unrestricted net liability	<u>(189,304)</u>	<u>(205,227)</u>
Total net assets	\$ <u>201,017,657</u>	<u>185,247,818</u>

See accompanying notes and independent auditor's report.

**OKLAHOMA DEPARTMENT OF ENVIRONMENTAL QUALITY
OKLAHOMA DRINKING WATER STATE REVOLVING FUND LOAN PROGRAM**

**STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
For the Years Ended June 30, 2011 and 2010**

	<u>2011</u>	<u>2010</u>
REVENUES		
Operating revenues:		
Federal grants	\$ 5,056,740	4,496,560
Interest income on loans	<u>10,679,657</u>	<u>8,447,850</u>
Total operating revenue	<u>15,736,397</u>	<u>12,944,410</u>
EXPENSES		
Operating expenses:		
Salaries and benefits	2,952,496	2,996,813
Professional services	774,759	656,061
Travel	78,747	83,450
Office	105,198	18,592
Depreciation	42,618	42,616
Indirect costs	652,861	589,406
Other expense	476,756	115,000
Interest expense	11,919,490	9,675,333
Bad debt expense (recovery)	282,790	(68,286)
Debt issuance costs	100,287	79,048
Trustee fees	36,652	25,824
Total operating expenses	<u>17,422,654</u>	<u>14,213,857</u>
Operating income (loss)	<u>(1,686,257)</u>	<u>(1,269,447)</u>
NONOPERATING REVENUES (EXPENSES)		
Federal grants	22,557,107	22,023,816
Federal grants-principal forgiveness	(8,920,694)	(22,023,816)
Investment income	3,414,029	3,752,806
Interest income-invested cash balances	371,841	270,869
Total nonoperating revenues	<u>17,422,283</u>	<u>4,023,675</u>
Income (loss) before transfers	15,736,026	2,754,228
Transfers in - Clean Water State Revolving Fund Loan Account Program	-	8,679,660
Transfers in - Drinking Water Treatment Loan Administrative Fund	33,813	49,248
Increase in net assets	15,769,839	11,483,136
NET ASSETS		
Net assets, beginning of year	<u>185,247,818</u>	<u>173,764,682</u>
Net assets, end of year	\$ <u>201,017,657</u>	\$ <u>185,247,818</u>

See accompanying notes and independent auditor's report.

**OKLAHOMA DEPARTMENT OF ENVIRONMENTAL QUALITY
OKLAHOMA DRINKING WATER STATE REVOLVING FUND LOAN PROGRAM**

**STATEMENTS OF CASH FLOWS
For the Years Ended June 30, 2011 and 2010**

	<u>2011</u>	<u>2010</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Federal grant receipts	\$ 5,237,921	4,389,586
Collection of interest on loans to local governmental units	9,873,268	7,912,737
Payments to employees	(2,968,419)	(3,040,647)
Payments to suppliers	(2,302,016)	(1,454,516)
Interest paid on debt	(13,295,261)	(8,690,795)
Net cash provided (used) by operating activities	<u>(3,454,507)</u>	<u>(883,635)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Proceeds from sale of bonds, net	60,495,560	102,122,438
Payments for debt issuance costs	(512,141)	(733,032)
Principal paid on notes	(8,675,000)	(8,465,000)
Federal grant receipts	13,636,413	-
Transfers in - Drinking Water Treatment Loan Administrative Fund	33,813	49,248
Transfers in - Clean Water State Revolving Loan Program	-	8,679,660
Net cash provided (used) by noncapital financing activities	<u>64,978,645</u>	<u>101,653,314</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchase of equipment	-	(10,467)
Net cash (used) in capital and related financing activities	<u>-</u>	<u>(10,467)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Loans to local governmental units	(118,954,723)	(91,153,996)
Collection of principal on loans to local governmental units	14,905,615	17,225,392
Collection of principal on loans to local governmental units from federal grant proceeds	8,920,694	22,023,816
Interest on investments	3,453,995	3,777,994
Interest on invested cash balances	416,153	253,924
Sales of investments	9,635,993	6,244,378
Net cash provided (used) by investing activities	<u>(81,622,273)</u>	<u>(41,628,492)</u>
Net increase (decrease) in cash	(20,098,135)	59,130,720
Cash and cash equivalents, beginning of year	77,326,022	18,195,302
Cash and cash equivalents, end of year	\$ <u>57,227,887</u>	<u>77,326,022</u>
RECONCILIATION OF NET OPERATING REVENUES (EXPENSES) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES:		
Operating income (loss)	\$ (1,686,257)	(1,269,447)
Adjustment to reconcile net operating income to net cash provided by operating activities:		
Depreciation	42,618	42,616
Amortization of debt issuance costs/note premium	(942,613)	(760,930)
Provision (recovery) for uncollectible loans	282,790	(68,286)
Changes in operating assets and liabilities:		
Decrease (Increase) in letter of credit payments receivable	181,181	(106,974)
Decrease (Increase) in interest receivable	(806,389)	(535,113)
Decrease (Increase) in other receivable	75,125	(75,125)
Increase (Decrease) in accounts payable	17,371	42,882
Increase (Decrease) in due to/from ODEQ	(198,552)	64,092
Increase (Decrease) in compensated absences	(15,923)	(43,834)
Increase (Decrease) in other accrued liabilities	4,138	1,968
Increase (Decrease) in interest payable	(407,996)	1,824,516
Net cash provided (used) by operating activities	\$ <u>(3,454,507)</u>	<u>(883,635)</u>

See accompanying notes and independent auditor's report.

**OKLAHOMA DEPARTMENT OF ENVIRONMENTAL QUALITY
OKLAHOMA DRINKING WATER STATE REVOLVING FUND LOAN PROGRAM**

**NOTES TO FINANCIAL STATEMENTS
June 30, 2011 and 2010**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The Oklahoma Department of Environmental Quality/Oklahoma Drinking Water State Revolving Fund Loan Program (the "Program") was created pursuant to the Federal Safe Drinking Water Act Amendments of 1995 (the "Act"), Section 1452, to provide a perpetual fund for financing the construction of drinking water treatment facilities for municipalities and other entities. The program utilizes Federal Capitalization grants, required State matching funds equal to 20% of federal funds received, and interest income for drinking water loan assistance. Standard loans made by the Program must be repaid within 20 years from construction completion. All repayments, including interest and principal, must remain in the fund.

The Program consists of two program components: 1) set-aside funds and 2) loan fund. The set-aside funds are administered by the Oklahoma Department of Environmental Quality ("ODEQ"). ODEQ's primary activities include providing direct assistance and managing the coordination of the Program to meet its primary objective pursuant to the Act. The loan fund is administered by the Oklahoma Water Resources Board ("OWRB") pursuant to an interagency agreement between ODEQ and OWRB. The OWRB handles certain financial functions, including the originating, approving and servicing loans made to qualifying recipients.

Basis of Accounting

The Program prepares its financial statements under the provisions of Governmental Accounting Standards Board's Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis -for State and Local Governments* ("GASB 34"), as amended by GASB 37 and Statement No. 38, *Certain Financial Statement Note Disclosures* ("GASB 38"). GASB 34, 37 and 38, among other provisions, establish a basic financial reporting model, and require management's discussion and analysis and certain financial statement note disclosures.

The financial statements of the Program are prepared under the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when incurred. The Program has elected to apply all applicable Governmental Accounting Standards Board ("GASB") pronouncements as well as all Financial Accounting Standards Board ("FASB") and Accounting Principles Board ("APB") opinions issued on or before November 30, 1989, unless those pronouncements conflict with or contradict statements and GASB pronouncements, in which case GASB prevails.

**OKLAHOMA DEPARTMENT OF ENVIRONMENTAL QUALITY
OKLAHOMA DRINKING WATER STATE REVOLVING FUND LOAN PROGRAM**

**NOTES TO FINANCIAL STATEMENTS
June 30, 2011 and 2010**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Federal Letter of Credit Payments Receivable

Funding from Federal grants is provided through a Federal letter of credit ("LOC"). The Program records revenue as qualifying expenditures are made or as expenses are incurred, as appropriate. Availability of funds under the LOC is specified by the terms of the grant. The Program draws on the available funds as necessary to fund operations and selected loans.

Federal Grants

Federal grants are recognized as operating revenue upon payment of allowable grant expenditures eligible for reimbursement from the EPA and not covered by state matching or program income.

Cash and Cash Equivalents

The Program considers all highly liquid debt instruments purchased with an original maturity of three months or less and money market funds to be cash equivalents.

Restricted Cash

Restricted cash represents the portion of the Program's cash balance at year-end that has been obligated for known future expenditures, such as loans, which have been approved and are complete as to all application requirements. The restricted portion fluctuates as obligated funds are used or as funds are de-obligated.

Restricted Investments

Restricted investments represent a portion of the Series 2003 Revenue Bonds and the Series 2004 Revenue Bonds temporarily invested pending their use in funding future loans plus additional funds set-aside into a Debt Service Reserve fund. The Debt Service Reserve fund portion of restricted investments totals \$62,766,930 at June 30, 2011. (See Note 5).

**OKLAHOMA DEPARTMENT OF ENVIRONMENTAL QUALITY
OKLAHOMA DRINKING WATER STATE REVOLVING FUND LOAN PROGRAM**

**NOTES TO FINANCIAL STATEMENTS
June 30, 2011 and 2010**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Equipment

Equipment is recorded at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets ranging from three to nine years. The Program's policy is to capitalize individual asset purchases in excess of \$5,000.

Debt Issuance Costs

Debt issuance costs are amortized using the straight-line method over the life of the bonds payable.

Bond Issue Premium

The Program's State Revolving Fund Revenue Bonds, Series 2011, Series 2010, Series 2004 and Series 2003 were initially sold at a premium of \$19,168,508. The bond premium is being amortized over the remaining life of the bonds. Net amortization expense of \$1,042,900 and \$839,978 was recorded in 2011 and 2010, respectively, and is included in interest expense in the accompanying statements of revenues, expenses, and changes in net assets.

Loan Administration Fees

Loan administrative fees are assessed to each participating borrower by the OWRB at the rate of one-half of one percent per annum of the amount of each borrower's loan balance outstanding. Fees paid by the participating borrowers are remitted directly to OWRB and, therefore, are not included in the accompanying Loan Program financial statements. These fees are deposited into the Drinking Water Loan Administration Fund, an account held outside the Program. The activity within this fund for the years ended June 30, 2011 and 2010 was as follows:

Balance, July 1, 2010	\$ 3,391,621	Balance, July 1, 2009	\$ 2,398,570
Fee income	1,761,127	Fee income	1,374,999
Interest income	92,313	Interest income	78,182
Operating expenses	(158,761)	Operating expenses	(410,882)
Transfers	<u>(33,813)</u>	Transfers	<u>(49,248)</u>
Balance, June 30, 2011	\$ <u>5,052,487</u>	Balance, June 30, 2010	\$ <u>3,391,621</u>

**OKLAHOMA DEPARTMENT OF ENVIRONMENTAL QUALITY
OKLAHOMA DRINKING WATER STATE REVOLVING FUND LOAN PROGRAM**

**NOTES TO FINANCIAL STATEMENTS
June 30, 2011 and 2010**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Unrestricted Net Liability

The unrestricted net liability at June 30, 2011 and 2010, is attributed to the accrual for compensated absences for financial reporting purposes in advance of reimbursement of such costs under the Program's federal funding arrangements.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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.

2. CASH DEPOSITS AND INVESTMENT RISK

Cash of \$2,465,111 and \$19,224,388 at June 30, 2011 and 2010 respectively, was on deposit in the State Treasurer's office's internal investment pool – *OK Invest*. Restricted cash of \$54,762,776 and \$58,101,634 at June 30, 2011 and 2010 respectively, was on deposit with the Program's trustee. The deposits are invested in the *Federated Treasury Obligations* mutual fund.

Investment Interest Rate Risk – the Program does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates as it relates to funds not directly associated with bond issue proceeds. For proceeds from debt issued by the Program, the bond indenture provides that initial bond proceeds be invested in an investment agreement that provides for an interest rate return equal to the interest due on the bonds for the initial loan period, 3 years.

Investment Credit Risk-Non Debt Proceeds – for non-debt proceeds, the Program has no investment policy that limits its investment choices other than the limitation of state law imposed on the State Treasurer as follows:

- a. U.S. Treasury Bills, Notes and Bonds and U.S. Government Agency Securities with certain ratings and maturity limitations.
- b. Collateralized or insured certificates of deposit and other evidences of deposit issued by a bank, savings bank, savings and loan association or credit union located in the state.

**OKLAHOMA DEPARTMENT OF ENVIRONMENTAL QUALITY
OKLAHOMA DRINKING WATER STATE REVOLVING FUND LOAN PROGRAM**

NOTES TO FINANCIAL STATEMENTS

June 30, 2011 and 2010

2. CASH DEPOSITS AND INVESTMENT RISK (Cont'd)

- c. With certain ratings and maturity limitations, negotiable certificates of deposit, bankers acceptances and commercial paper.
- d. Obligations of state and local governments, including obligations of Oklahoma state public trusts, with certain ratings and maturity limitations.
- e. Collateralized repurchase agreements tri-party repurchase agreements.
- f. Money market mutual funds and short term bond funds regulated by the Securities and Exchange Commission (SEC) and in which investments consist of obligations of the U.S. Government and its agencies and instrumentalities and repurchase agreements collateralized by obligations of the U.S. Government and its agencies and instrumentalities.

The state treasurer has determined that current holdings in *OK Invest* should be limited to obligations of the United States government, its agencies and instrumentalities, tri-party repurchase agreements collateralized at 102% with the collateral held by a third party in the name of the Oklahoma State Treasurer and money market mutual funds which either directly or indirectly invest in U.S. Treasury and/or Agency securities and repurchase agreements related to such securities. *OK Invest* is not insured or guaranteed by the State of Oklahoma, the Federal Deposit Insurance Corporation or any other government agency.

Investment Credit Risk - Debt Proceeds – for debt proceeds, the bond indenture provides for restrictions on the investment choices of the Program as follows:

- a. Obligations of the United States Government, its agencies and instrumentalities.
- b. Collateralized or insured certificates of deposit and other evidences of deposit at banks, savings banks, savings and loan associations or credit unions located in the State of Oklahoma.
- c. Money market funds regulated by the Securities and Exchange Commission and which investments consist of those items specified in (a) and (b) above.
- d. Investment agreements with entities maintaining a rating in the top two categories by a nationally recognized municipal bond rating agency.

**OKLAHOMA DEPARTMENT OF ENVIRONMENTAL QUALITY
OKLAHOMA DRINKING WATER STATE REVOLVING FUND LOAN PROGRAM**

**NOTES TO FINANCIAL STATEMENTS
June 30, 2011 and 2010**

2. CASH DEPOSITS AND INVESTMENT RISK (Cont'd)

At June 30, 2011, the Program's investments in obligations not directly guaranteed by the U.S. Government and investments in money market mutual funds were rated as follows:

Description	Financial Institution	Amount	Average Maturity/ Due Date	Rating
OK Invest	State Treasurer	\$ 2,465,111	Less than 2 years	Not rated.
Federated Treasury Obligations Fund	BancTrust	\$ 54,762,776	28 days	AAAm
Transamerica Life Insurance and Annuity Co. - GIC	AEGON			See Note 5
Reserve Fund		\$ 34,082,080	4/1/2025	"
Revenue Fund		\$ 445,689	4/1/2025	"
Transamerica Occidental Life Insurance Company - GIC	AEGON			See Note 5
Reserve Fund		\$ 28,684,850	4/1/2027	"
Revenue Fund		\$ 355,666	4/1/2027	"

Concentration of Investment Credit Risk – neither the Program nor the bond indenture place any limit on the amount the Program may invest in any one issuer. The Program has the following concentration of credit risk: 53% or \$63,568,285 is invested in guaranteed investment agreements with Transamerica Occidental Life Insurance Co./Transamerica Life Insurance and Annuity Co.

A "pooled cash" concept is used by ODEQ in maintaining cash and equivalents for the Program's Set Aside accounts. Under this method, cash and equivalents are pooled and each ODEQ program has equity in the pooled amount. There were no pooled cash overdrafts included in Due to ODEQ in the current year.

**OKLAHOMA DEPARTMENT OF ENVIRONMENTAL QUALITY
OKLAHOMA DRINKING WATER STATE REVOLVING FUND LOAN PROGRAM**

**NOTES TO FINANCIAL STATEMENTS
June 30, 2011 and 2010**

3. FEDERAL LETTERS OF CREDIT

Federal letters of credit ("LOC") balances at June 30, 2011 and 2010 are as follows:

	Year Ended June 30, 2011					
	Administrative & ARRA Administrative	Program Management & Reserve	Small Systems	Local Assistance	Loan	Totals
LOC available for draw	\$ 7,254,745	13,868,733	2,892,888	13,600,182	174,881,452	212,498,000
Cumulative cash draws	7,118,038	12,291,779	2,742,202	11,753,594	170,528,363	204,433,976
LOC balance available for draw at June 30, 2011	\$ <u>136,707</u>	<u>1,576,954</u>	<u>150,686</u>	<u>1,846,588</u>	<u>4,353,089</u>	<u>8,064,024</u>

	Year Ended June 30, 2010					
	Administrative & ARRA Administrative	Program Management & Reserve	Small Systems	Local Assistance	Loan	Totals
LOC available for draw	\$ 6,580,227	12,182,433	2,555,628	11,070,730	163,245,982	195,635,000
Cumulative cash draws	5,900,611	10,300,554	2,465,386	10,001,141	147,971,256	176,638,948
LOC balance available for draw at June 30, 2010	\$ <u>679,616</u>	<u>1,881,879</u>	<u>90,242</u>	<u>1,069,589</u>	<u>15,274,726</u>	<u>18,996,052</u>

Due to the fact that the grants cover a period of more than 8 quarters, not all of the balances presented above are available for immediate drawdown.

4. LOANS RECEIVABLE

The Program originates interim, small community and large community loans with Oklahoma municipalities and other entities for financing the construction of drinking water treatment facilities which are payable in semiannual installments at subsidized rates. Funded projects of the Program must meet established eligibility requirements. Effective interest rates on the outstanding loans vary from 0% to 3.45% at June 30, 2011 and 2010.

**OKLAHOMA DEPARTMENT OF ENVIRONMENTAL QUALITY
OKLAHOMA DRINKING WATER STATE REVOLVING FUND LOAN PROGRAM**

**NOTES TO FINANCIAL STATEMENTS
June 30, 2011 and 2010**

4. LOANS RECEIVABLE (Cont'd)

Up to 30% of the federal grant can be used for principal forgiveness for communities meeting "disadvantaged" criteria. As of June 30, 2011 and 2010, no disadvantaged community loans were made. Loans are collateralized by various revenue sources including, but not limited to, user charges and sales taxes collected by the borrowers. Principal payments must start within one year of construction completion or at an earlier date set in the loan agreement. During the years ended June 30, 2011 and 2010, principal payments of \$23,826,309 and \$39,249,208, respectively, had been received.

The allowance for loan losses at June 30, 2011 of \$492,617 is based upon management's evaluation of the collectability of the loans. The evaluation takes into consideration such factors as size of the individual loans, overall quality, current economic conditions and trends that may affect the borrowers' ability to pay.

Loans receivable activity from July 1, 2009 to June 30, 2011, is as follows:

Balance, June 30, 2009	260,816,670
Loan disbursements	91,153,996
Loan principal repayments	(39,249,208)
Change in provision for uncollectible loans	<u>68,286</u>
Balance, June 30, 2010	312,789,744
Loan disbursements	118,954,723
Loan principal repayments	(23,826,309)
	<u>407,918,158</u>
Change in provision for uncollectible loans	<u>(282,790)</u>
Balance, June 30, 2011	\$ <u><u>407,635,368</u></u>

**OKLAHOMA DEPARTMENT OF ENVIRONMENTAL QUALITY
OKLAHOMA DRINKING WATER STATE REVOLVING FUND LOAN PROGRAM**

**NOTES TO FINANCIAL STATEMENTS
June 30, 2011 and 2010**

5. RESTRICTED INVESTMENTS

A description of the restricted investments held at June 30, 2011 and 2010, is as follows:

	<u>2011</u>	<u>2010</u>
Guaranteed investment with Transamerica Life Insurance and Annuity Co. pursuant to an investment agreement, 4.80%, maturing April 1, 2025 (restricted for reserve fund).	\$ 34,082,080	36,024,240
Guaranteed investment with Transamerica Life Insurance and Annuity Co. pursuant to an investment agreement, 4.80%, maturing April 1, 2025 (restricted for revenue fund).	445,689	3,538,738
Guaranteed investment with Transamerica Occidental Life Insurance Co. pursuant to an investment agreement, 4.61%, maturing April 1, 2027 (restricted for reserve fund).	28,684,850	30,058,463
Guaranteed investment with Transamerica Occidental Life Insurance Co. pursuant to an investment agreement, 4.40%, maturing April 1, 2027 (restricted for revenue fund).	<u>355,666</u>	<u>3,582,837</u>
Total restricted investments	\$ <u>63,568,285</u>	<u>73,204,278</u>

The agreements with Transamerica Occidental Life Insurance Co./Transamerica Life Insurance and Annuity Co. ("Transamerica"), are uninsured and non-collateralized so long as Transamerica maintains certain specified credit ratings. If these credit ratings are not maintained, Transamerica is required to collateralize the investment agreement sufficient to maintain an S & P or Moody's rating of "AA-" or "Aa3", respectively, on the contract. The S & P credit rating for Transamerica at June 30, 2011 was AA-. The investment is carried at cost, which approximates fair value.

6. BINDING COMMITMENTS

The OWRB, pursuant to an interagency agreement entered into between ODEQ and OWRB, approves funding of various loan applications through the Program. These binding commitments will be funded by the Program provided that a loan agreement and promissory note are executed within one year from the date of original approval unless an extension is granted by the OWRB. Binding commitments approved by the OWRB for which a loan agreement and promissory note have not been executed totaled \$0 and \$13,924,607 at June 30, 2011 and 2010, respectively.

**OKLAHOMA DEPARTMENT OF ENVIRONMENTAL QUALITY
OKLAHOMA DRINKING WATER STATE REVOLVING FUND LOAN PROGRAM**

**NOTES TO FINANCIAL STATEMENTS
June 30, 2011 and 2010**

7. EQUIPMENT

A summary of changes to equipment is as follows:

		<u>Year ended 2011</u>		
		<u>June 30,</u>		<u>June 30,</u>
		<u>2010</u>	<u>Additions</u>	<u>2011</u>
Equipment	\$	763,271	-	763,271
Accumulated depreciation		<u>(667,201)</u>	<u>(42,618)</u>	<u>(709,819)</u>
Net	\$	<u>96,070</u>	<u>(42,618)</u>	<u>53,452</u>

		<u>Year ended 2010</u>		
		<u>June 30,</u>		<u>June 30,</u>
		<u>2009</u>	<u>Additions</u>	<u>2010</u>
Equipment	\$	752,804	10,467	763,271
Accumulated depreciation		<u>(624,585)</u>	<u>(42,616)</u>	<u>(667,201)</u>
Net	\$	<u>128,219</u>	<u>(32,149)</u>	<u>96,070</u>

8. LONG-TERM DEBT

Bonds Payable

On April 13, 2011, the Program issued State Revolving Fund Revenue Bonds, Series 2011 in the amount of \$57,910,000. The bonds are secured by the loans made to the local entities by the OWRB, investment income in the Drinking Water State Revolving Fund Account and monies held in the Debt Service Reserve Fund. These bonds were issued to provide low interest cost financing for Oklahoma Local governmental entities for acquiring, constructing, or improving their wastewater treatment systems and to enable the Program to meet the State matching requirements in order to obtain Federal grants.

On January 13, 2010, the Program issued State Revolving Fund Revenue Bonds, Series 2010 in the amount of \$94,460,000. The bonds are secured by the loans made to the local entities by the OWRB, investment income in the Drinking Water State Revolving Fund Account and monies held in the Debt Service Reserve Fund. These bonds were issued to provide low interest cost financing for Oklahoma Local governmental entities for acquiring, constructing, or improving their wastewater treatment systems and to enable the Program to meet the State matching requirements in order to obtain Federal grants.

**OKLAHOMA DEPARTMENT OF ENVIRONMENTAL QUALITY
OKLAHOMA DRINKING WATER STATE REVOLVING FUND LOAN PROGRAM**

**NOTES TO FINANCIAL STATEMENTS
June 30, 2011 and 2010**

8. LONG-TERM DEBT (Cont'd)

Bonds Payable (Cont'd)

Long-term debt outstanding at June 30, 2011 and 2010 are as follows:

	<u>2011</u>	<u>2010</u>
BONDS PAYABLE:		
Serial 2011 bonds due April 1, 2013 to April 1, 2042, interest at 2.00% to 5.25%	\$ 57,910,000	-
Serial 2010 bonds due April 1, 2012 to April 1, 2032, interest at 2.00% to 5.00%	94,460,000	94,460,000
Serial 2004 bonds due April 1, 2011 to April 1, 2027, interest at 3.125% to 5.25%	70,375,000	73,745,000
Serial 2003 Bonds due April 1, 2011 to April 1, 2025, interest at 3.40% to 5.25%	<u>93,095,000</u>	<u>98,400,000</u>
Total Bonds Payable	315,840,000	266,605,000
Current maturities	(11,265,000)	(8,675,000)
Unamortized (discount)/ premium	<u>13,618,404</u>	<u>12,075,044</u>
Long-term debt, net of unamortized (discount)/ premium	<u>\$ 318,193,404</u>	<u>270,005,044</u>

OKLAHOMA DEPARTMENT OF ENVIRONMENTAL QUALITY
OKLAHOMA DRINKING WATER STATE REVOLVING FUND LOAN PROGRAM

SUPPLEMENTAL COMBINING STATEMENT OF NET ASSETS INFORMATION - BY PROGRAM COMPONENT
June 30, 2011

	Set-Aside Funds						Loan Fund	Totals
	Administrative	Program Management	Small Systems	Local Assistance and Other State Programs	ARRA Admin	Program Mgmt Reserve		
ASSETS								
Current Assets:								
Cash	\$ -	-	-	-	-	-	2,465,111	2,465,111
Federal letter of credit payments receivable	16,755	73,963	47,271	391,493	38,110	60,229	-	627,821
Accrued interest on loans receivable	-	-	-	-	-	-	3,414,224	3,414,224
Other interest receivable	-	-	-	-	-	-	252,783	252,783
Current portion of loans receivable-								
Small community loans	-	-	-	-	-	-	18,363,401	18,363,401
Large community loans	-	-	-	-	-	-	481,019	481,019
Total current assets	<u>16,755</u>	<u>73,963</u>	<u>47,271</u>	<u>391,493</u>	<u>38,110</u>	<u>60,229</u>	<u>24,976,538</u>	<u>25,604,359</u>
Noncurrent Assets:								
Restricted Cash	-	-	-	-	-	-	54,762,776	54,762,776
Restricted investments	-	-	-	-	-	-	63,568,285	63,568,285
Loans receivable, net of current portion and allowance for uncollectible loans of \$492,617								
Small community loans	-	-	-	-	-	-	382,621,657	382,621,657
Large community loans	-	-	-	-	-	-	6,169,291	6,169,291
Equipment, net	9,310	1,753	-	42,389	-	-	-	53,452
Debt issuance cost, net	-	-	-	-	-	-	2,114,855	2,114,855
Total noncurrent assets	<u>9,310</u>	<u>1,753</u>	<u>-</u>	<u>42,389</u>	<u>-</u>	<u>-</u>	<u>509,236,864</u>	<u>509,290,316</u>
Total assets	<u>26,065</u>	<u>75,716</u>	<u>47,271</u>	<u>433,882</u>	<u>38,110</u>	<u>60,229</u>	<u>534,213,402</u>	<u>534,894,675</u>
LIABILITIES								
Current Liabilities:								
Accounts payable	1,662	1,292	339	107,485	5,517	1,736	12,270	130,301
Due to Oklahoma Department of Environmental Quality ("ODEQ")	15,093	72,671	46,932	284,008	32,593	58,493	-	509,790
Compensated absences	3,916	13,677	1,516	10,012	-	6,533	-	35,654
Interest Payable	-	-	-	-	-	-	3,589,219	3,589,219
Current maturities of long-term debt	-	-	-	-	-	-	11,265,000	11,265,000
Total current liabilities	<u>20,671</u>	<u>87,640</u>	<u>48,787</u>	<u>401,505</u>	<u>38,110</u>	<u>66,762</u>	<u>14,866,489</u>	<u>15,529,964</u>
Noncurrent Liabilities:								
Compensated absences	16,875	58,936	6,536	43,147	-	28,156	-	153,650
Long-term debt, net of current maturities	-	-	-	-	-	-	304,575,000	304,575,000
Unamortized (discount)/premium	-	-	-	-	-	-	13,618,404	13,618,404
Total noncurrent liabilities	<u>16,875</u>	<u>58,936</u>	<u>6,536</u>	<u>43,147</u>	<u>-</u>	<u>28,156</u>	<u>318,193,404</u>	<u>318,347,054</u>
Total liabilities	<u>37,546</u>	<u>146,576</u>	<u>55,323</u>	<u>444,652</u>	<u>38,110</u>	<u>94,918</u>	<u>333,059,893</u>	<u>333,877,018</u>
NET ASSETS								
Invested in capital assets, net of related debt	9,310	1,753	-	42,389	-	-	-	53,452
Restricted for loans and debt service	-	-	-	-	-	-	201,153,509	201,153,509
Unrestricted net liability	(20,791)	(72,613)	(8,052)	(53,159)	-	(34,689)	-	(189,304)
Total net assets	<u>\$ (11,481)</u>	<u>(70,860)</u>	<u>(8,052)</u>	<u>(10,770)</u>	<u>-</u>	<u>(34,689)</u>	<u>201,153,509</u>	<u>201,017,657</u>

OKLAHOMA DEPARTMENT OF ENVIRONMENTAL QUALITY
OKLAHOMA DRINKING WATER STATE REVOLVING FUND LOAN PROGRAM

SUPPLEMENTAL COMBINING STATEMENT OF REVENUES, EXPENSES AND CHANGES IN
NET ASSETS INFORMATION - BY PROGRAM COMPONENT
For the Year Ended June 30, 2011

	Set-Aside Funds						Loan Fund	Totals
	Administrative	Program Management	Small Systems	Local Assistance and Other State Programs	ARRA Admin	Program Mgmt Reserve		
REVENUES								
Operating revenues:								
Federal grants	\$ 670,674	1,481,137	287,703	1,902,727	431,846	282,653	-	5,056,740
Interest income on loans	-	-	-	-	-	-	10,679,657	10,679,657
Total operating revenue	670,674	1,481,137	287,703	1,902,727	431,846	282,653	10,679,657	15,736,397
EXPENSES								
Operating expenses:								
Salaries and benefits	343,743	1,165,660	223,717	922,564	259,439	37,373	-	2,952,496
Professional services	220,000	252	-	459,375	90,162	4,970	-	774,759
Travel	17,088	27,561	1,710	12,983	19,405	-	-	78,747
Office	7,629	14,091	2,798	75,149	5,531	-	-	105,198
Depreciation	5,234	3,506	-	33,878	-	-	-	42,618
Indirect costs	77,274	260,785	51,217	205,222	57,309	1,054	-	652,861
Other expense	-	-	-	202,811	-	273,945	-	476,756
Interest expense	-	-	-	-	-	-	11,919,490	11,919,490
Bad debt expense	-	-	-	-	-	-	282,790	282,790
Debt issuance costs	-	-	-	-	-	-	100,287	100,287
Trustee fees	-	-	-	-	-	-	36,652	36,652
Total operating expenses	670,968	1,471,855	279,442	1,911,982	431,846	317,342	12,339,219	17,422,654
Operating income (loss)	(294)	9,282	8,261	(9,255)	-	(34,689)	(1,659,562)	(1,686,257)
NONOPERATING REVENUES (EXPENSES)								
Federal grants	-	-	-	-	-	-	22,557,107	22,557,107
Federal grants-Principal Forgiveness	-	-	-	-	-	-	(8,920,694)	(8,920,694)
Investment income	-	-	-	-	-	-	3,414,029	3,414,029
Interest income-invested cash balances	-	-	-	-	-	-	371,841	371,841
Net nonoperating revenues	-	-	-	-	-	-	17,422,283	17,422,283
Income (loss) before transfers	(294)	9,282	8,261	(9,255)	-	(34,689)	15,762,721	15,736,026
Transfers in - Drinking Water Treatment Loan Admin Fund	-	-	-	-	-	-	33,813	33,813
Increase (decrease) in net assets	(294)	9,282	8,261	(9,255)	-	(34,689)	15,796,534	15,769,839
NET ASSETS								
Net assets, beginning of year	(11,187)	(80,142)	(16,313)	(1,515)	-	-	185,356,975	185,247,818
Net assets, end of year	\$ (11,481)	(70,860)	(8,052)	(10,770)	-	(34,689)	201,153,509	201,017,657

OKLAHOMA DEPARTMENT OF ENVIRONMENTAL QUALITY
OKLAHOMA DRINKING WATER STATE REVOLVING FUND LOAN PROGRAM

SUPPLEMENTAL COMBINING STATEMENT OF CASH FLOWS INFORMATION - BY PROGRAM COMPONENT
For the Year Ended June 30, 2011

	Set-Aside Funds						Loan Fund	Totals
	Administrative	Program Management	Small Systems	Local Assistance and Other State Programs	ARRA Admin	Program Mgmt Reserve		
CASH FLOWS FROM OPERATING ACTIVITIES								
Federal grant receipts	\$ 722,824	1,565,756	276,816	1,752,453	494,603	425,469	-	5,237,921
Collection of interest on loans to local governmental units	-	-	-	-	-	-	9,873,268	9,873,268
Payments to employees	(348,683)	(1,178,448)	(231,978)	(947,187)	(259,439)	(2,684)	-	(2,968,419)
Payments to other suppliers	(374,141)	(387,308)	(44,838)	(805,266)	(235,164)	(422,785)	(32,514)	(2,302,016)
Interest paid on debt	-	-	-	-	-	-	(13,295,261)	(13,295,261)
Net cash provided (used) by operating activities	-	-	-	-	-	-	(3,454,507)	(3,454,507)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES								
Proceeds from sale of bonds, net	-	-	-	-	-	-	60,495,560	60,495,560
Payments for debt issuance costs	-	-	-	-	-	-	(512,141)	(512,141)
Principal paid on notes	-	-	-	-	-	-	(8,675,000)	(8,675,000)
Federal grant receipts	-	-	-	-	-	-	13,636,413	13,636,413
Transfers in - Drinking Water Treatment Loan Admin. Fund	-	-	-	-	-	-	33,813	33,813
Net cash provided (used) by noncapital financing activities	-	-	-	-	-	-	64,978,645	64,978,645
CASH FLOWS FROM INVESTING ACTIVITIES								
Loans to local governmental units	-	-	-	-	-	-	(118,954,723)	(118,954,723)
Collection of principal on loans to local governmental units	-	-	-	-	-	-	14,905,615	14,905,615
Collection of principal on loans to local governmental units from federal grant proceeds	-	-	-	-	-	-	8,920,694	8,920,694
Interest on investments	-	-	-	-	-	-	3,453,995	3,453,995
Interest on invested cash balances	-	-	-	-	-	-	416,153	416,153
Purchase of investments	-	-	-	-	-	-	9,635,993	9,635,993
Net cash provided (used) by investing activities	-	-	-	-	-	-	(81,622,273)	(81,622,273)
Net increase (decrease) in cash	-	-	-	-	-	-	(20,098,135)	(20,098,135)
Cash and cash equivalents, beginning of year	-	-	-	-	-	-	77,326,022	77,326,022
Cash and cash equivalents, end of year	\$ -	-	-	-	-	-	57,227,887	57,227,887
RECONCILIATION OF NET OPERATING REVENUES (EXPENSES) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES:								
Operating income (loss)	\$ (294)	9,282	8,261	(9,255)	-	(34,689)	(1,659,562)	(1,686,257)
Adjustment to reconcile net operating income to net cash provided by operating activities:								
Depreciation	5,234	3,506	-	33,878	-	-	-	42,618
Amortization of debt issuance costs/note premium	-	-	-	-	-	-	(942,613)	(942,613)
Provision (recovery) for uncollectible loans	-	-	-	-	-	-	282,790	282,790
Changes in operating assets and liabilities:								
Decrease (Increase) in letter of credit payments receivable	52,150	84,619	(10,887)	(150,274)	62,757	142,816	-	181,181
Decrease (Increase) in interest receivable	-	-	-	-	-	-	(806,389)	(806,389)
Decrease (Increase) in other receivable	-	-	-	-	-	-	75,125	75,125
Increase (Decrease) in accounts payable	(49,063)	(3,462)	(84)	82,009	(6,665)	(5,364)	-	17,371
Increase (Decrease) in due to/from ODEQ	(3,087)	(81,157)	10,971	68,265	(56,092)	(137,452)	-	(198,552)
Increase (Decrease) in compensated absences	(4,940)	(12,788)	(8,261)	(24,623)	-	34,689	-	(15,923)
Increase (Decrease) in other accrued liabilities	-	-	-	-	-	-	4,138	4,138
Increase (Decrease) in interest payable	-	-	-	-	-	-	(407,996)	(407,996)
Net cash provided (used) by operating activities	\$ -	-	-	-	-	-	(3,454,507)	(3,454,507)