

**AUDIT REPORT  
OF THE  
NEBRASKA DEPARTMENT OF  
ENVIRONMENTAL QUALITY  
DRINKING WATER STATE REVOLVING FUND PROGRAM  
JULY 1, 2006 THROUGH JUNE 30, 2007**

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**Issued on April 1, 2008**

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
DRINKING WATER STATE REVOLVING FUND PROGRAM

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NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
DRINKING WATER STATE REVOLVING FUND PROGRAM

**BACKGROUND**

The Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program (Program) was established pursuant to the Federal Safe Drinking Water Act of 1996. Neb. Rev. Stat. Sections 71-5314 to 71-5327 created the Drinking Water State Revolving Fund Act. The Federal Safe Drinking Water Act and State statutes established the Drinking Water State Revolving Fund Program to provide loans, at reduced interest rates, to finance the construction of publicly and privately owned drinking water facilities. Instead of making grants to communities that pay for a portion of the building of drinking water facilities, the Program provides for low interest loans to finance the entire cost of qualified projects. The Program provides a flexible financing source which can be used for a variety of projects. Loans made by the Program must be repaid within 20 years, and all repayments, including interest and principal, must be used for the purposes of the Program. Disadvantaged communities have 30 years to repay all loans.

The Program was capitalized by the United States Environmental Protection Agency (EPA) by a series of grants starting in 1997. States are required to provide an additional 20 percent of the Federal capitalization grant as matching funds in order to receive a Federal grant. As of June 30, 2007, the EPA had awarded \$84 million in capitalization grants to the State. The award of this \$84 million required the State to contribute approximately \$17 million in matching funds. The State provided appropriations to contribute \$2.33 million of the funds to meet the State's matching requirement. Additional matching funds were obtained through the issuance of revenue bonds of \$5,530,000 in June of 2000, \$1,815,000 in March of 2001, \$2,000,000 in December of 2002, \$1,700,000 in June of 2003, \$1,890,000 in September of 2004, \$1,920,000 in August 2005, and \$1,915,000 in June 2006.

The Program is administered by the Nebraska Department of Environmental Quality (Department) and the Nebraska Health and Human Services System – Regulation and Licensure. The Department's primary activities with regard to the Program include the making of loans for facilities and the management and coordination of the Program. The Nebraska Environmental Quality Council approves the rules and regulations of the Department and the Program's Intended Use Plan. The Nebraska Health and Human Services System – Regulation and Licensure sets the funding priorities.

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**EXIT CONFERENCE**

An exit conference was held February 26, 2008, with the Department to discuss the results of our examination. Those in attendance for the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program were:

<b>NAME</b>	<b>TITLE</b>
Thomas R. Lamberson	Deputy Director
Bart Moore	Budget Officer III



## NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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### NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY DRINKING WATER STATE REVOLVING FUND PROGRAM

#### **INDEPENDENT AUDITORS' REPORT**

Nebraska Department of Environmental Quality  
Lincoln, Nebraska

We have audited the accompanying financial statements of the business type activities of the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program (Program), as of and for the year ended June 30, 2007, as listed in the Table of Contents. 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 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 significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements of the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program, are intended to present the financial position and changes in financial position of only that portion of the business type activities of the State that is attributable to the transactions of the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program. They do not purport to, and do not, present fairly the financial position of the business type activities of the State of Nebraska as of June 30, 2007, and its changes in financial position 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 respective financial position of the business type activities of the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program, as of June 30, 2007, and the respective changes in financial position 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 our report dated March 25, 2008, on our consideration of the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

In accordance with the *U.S. Environmental Protection Agency Audit Guide for Clean Water and Drinking Water State Revolving Fund Programs*, we have also issued our report dated March 25, 2008, on our consideration of the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's compliance with certain provisions of laws, regulations, and grants.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Program's basic financial statements. Management's Discussion and Analysis is presented for purposes of additional analysis and is not a required part of the basic financial statements. The Management's Discussion and Analysis has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

Handwritten signature of Timothy J. Channer CPA in black ink.

Assistant Deputy Auditor

March 25, 2008

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
DRINKING WATER STATE REVOLVING FUND PROGRAM

**MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)**

This section of the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's (Program) financial report presents a narrative overview and analysis of the financial activities of the Program for the fiscal year ended June 30, 2007. This analysis has been prepared by management of the Department, and is intended to be read with the financial statements and related footnotes that follow this section.

**OVERVIEW OF THE FINANCIAL STATEMENTS**

This discussion and analysis is intended to serve as an introduction to the Program's basic financial statements. The Program's basic financial statements include: 1) Balance Sheet, 2) Statement of Revenues, Expenses, and Changes in Net Assets, 3) Statement of Cash Flows, and 4) Notes to the Financial Statements.

The Balance Sheet presents information on all of the Program's assets and liabilities, with the difference between the two reported as net assets. The Statement of Revenues, Expenses, and Changes in Net Assets presents information showing how the Program's net assets changed during the most recent fiscal year.

The Statement of Cash Flows presents the Program's flows of cash by defined categories. The primary purpose of the Statement of Cash Flows is to provide information about the Program's cash receipts and payments during the year.

The Notes to the Financial Statements provide additional information that is essential to a full understanding of the data provided in the financial statements.

**ANALYSIS OF BALANCES AND TRANSACTIONS OF ENTERPRISE FUND**

**Changes in Net Assets**

For the fiscal year ended June 30, 2007, net assets of the Program increased by 8%.

	2007	2006	% Change
<b>Current Assets</b>	\$ 22,973,033	\$ 22,040,621	4%
<b>Noncurrent Assets</b>	67,440,444	63,319,717	7%
Total Assets	90,413,477	85,360,338	6%
<b>Current Liabilities</b>	1,316,051	1,118,660	18%
<b>Noncurrent Liabilities</b>	12,865,000	13,805,000	(7%)
Total Liabilities	14,181,051	14,923,660	(5%)
<b>Net Assets</b>			
Restricted	1,587,620	1,587,620	-
Unrestricted	74,644,806	68,849,058	8%
Total Net Assets	\$ 76,232,426	\$ 70,436,678	8%

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
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**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
(Continued)

	2007	2006	% Change
<b>Loan Fees Administration</b>	\$ 692,034	\$ 623,714	11%
<b>Interest</b>	2,984,718	2,723,521	10%
<b>Miscellaneous Revenue</b>	-	28	(100%)
Total Operating Revenues	<u>3,676,752</u>	<u>3,347,263</u>	10%
<b>Administration</b>	1,553,089	2,094,436	(26%)
<b>Bond Expenses</b>	623,328	729,695	(15%)
Total Operating Expenses	<u>2,176,417</u>	<u>2,824,131</u>	(23%)
<b>Operating Income (Loss)</b>	1,500,335	523,132	187%
<b>Capital Federal Grants</b>	4,295,413	8,269,094	(48%)
<b>Change In Net Assets</b>	5,795,748	8,792,226	(34%)
<b>Net Assets, Beginning of Year</b>	<u>70,436,678</u>	<u>61,644,452</u>	14%
<b>Net Assets, End of Year</b>	<u>\$ 76,232,426</u>	<u>\$ 70,436,678</u>	8%

The most significant change from the fiscal year ended June 30, 2006, to the fiscal year ended June 30, 2007, was the amount received from Capital Federal Grants. The capitalization grants received from the EPA have shown a steady decline the past few years. Federal funds will vary each year depending on the size of each draw, the timing of each draw, the number of communities applying for loans, and the number of loans successfully processed. Changes are inherent in the Drinking Water program and are expected when draws are based on community requests. The need to draw down Capital Federal Grant money declined in fiscal year 2007.

### **ECONOMIC OUTLOOK**

No conditions were noted that would be expected to have a significant effect on the financial position or results of operation.

### **DEBT ADMINISTRATION**

#### **Long Term Debt**

The Drinking Water State Revolving Fund had long term debt activity during the fiscal year as shown above in the line titled Noncurrent Liabilities on the Change of Net Assets section.

See the Notes to the Financial Statements for more detailed information on the Bonds Payable, which represent the Fund's long term debt activity for the year.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
 DRINKING WATER STATE REVOLVING FUND PROGRAM  
**BALANCE SHEET**  
 June 30, 2007

	<u>Enterprise Fund</u>
<b>ASSETS</b>	
CURRENT ASSETS	
Cash & Cash Equivalents:	
Cash in State Treasury (Note 2)	\$ 11,644,143
Amounts Held by Trustee (Note 2)	7,640,876
Interest Receivable	56,769
Loans Receivable (Note 3)	3,631,245
<b>TOTAL CURRENT ASSETS</b>	<u>22,973,033</u>
NON-CURRENT ASSETS	
Loans Receivable (Note 3)	65,250,605
Long Term Investments (Note 2)	2,189,839
<b>TOTAL NON-CURRENT ASSETS</b>	<u>67,440,444</u>
<b>TOTAL ASSETS</b>	<u><u>\$ 90,413,477</u></u>
<b>LIABILITIES</b>	
CURRENT LIABILITIES	
Accounts Payable	\$ 67,860
Accrued Bond Interest Payable	308,191
Bonds Payable - Current (Note 4)	940,000
<b>TOTAL CURRENT LIABILITIES</b>	<u>1,316,051</u>
NON-CURRENT LIABILITIES	
Bonds Payable - Long Term (Note 4)	12,865,000
<b>TOTAL NON-CURRENT LIABILITIES</b>	<u>12,865,000</u>
<b>TOTAL LIABILITIES</b>	<u>14,181,051</u>
<b>NET ASSETS</b>	
Restricted for Bond Payments	1,587,620
Unrestricted	74,644,806
<b>TOTAL NET ASSETS</b>	<u>76,232,426</u>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<u><u>\$ 90,413,477</u></u>

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

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
DRINKING WATER STATE REVOLVING FUND PROGRAM  
**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS**  
For the Year Ended June 30, 2007

	<u>Enterprise Fund</u>
<b>OPERATING REVENUES:</b>	
Loan Fees Administration (Note 6)	\$ 692,034
Interest on Loans	2,106,855
Interest on Fund Balance - Trustee	393,223
Interest on Fund Balance - Long Term Investment (Note 7)	103,830
Interest on Fund Balance - State Operating Pool (Note 7)	380,810
<b>TOTAL OPERATING REVENUES</b>	<b>3,676,752</b>
<b>OPERATING EXPENSES:</b>	
4% Administration (Note 9)	389,329
15% Source Water Assessment Program (Note 9)	421,802
2% Technical Assistance to Small Systems (Note 9)	352,348
10% Public Water Supply System (Note 9)	330,376
30% Loan Forgiveness (Note 9)	59,196
Cost of Bond Issuance	38
Interest Expense - State Match Bonds (Note 9)	623,328
<b>TOTAL OPERATING EXPENSES</b>	<b>2,176,417</b>
<b>OPERATING INCOME</b>	1,500,335
<b>CAPITAL CONTRIBUTIONS - FEDERAL GRANTS</b>	4,295,413
<b>CHANGE IN NET ASSETS</b>	5,795,748
<b>TOTAL NET ASSETS, BEGINNING OF YEAR</b>	70,436,678
<b>TOTAL NET ASSETS, END OF YEAR</b>	<b>\$ 76,232,426</b>

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

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
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**STATEMENT OF CASH FLOWS**  
For the Year Ended June 30, 2007

	Enterprise Fund
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>	
Receipts From Customers	\$ 7,466,008
Interest on Investments	865,118
Payments to Borrowers	(6,397,747)
Payments to Employees and Vendors	(1,500,830)
Payment to Long Term Investments	(672,119)
Payment Due to Other Fund	(30,000)
Cost of Bond Issuance	(9,436)
Bond Principal Payments	(795,000)
Bond Interest Payments	(599,360)
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>(1,673,366)</b>
 <b>CASH FLOWS FROM NON-CAPITAL &amp; RELATED FINANCING ACTIVITIES:</b>	
Funds Received From the Environmental Protection Agency	4,295,413
<b>NET CASH FROM NON-CAPITAL &amp; RELATED FINANCING ACTIVITIES:</b>	4,295,413
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	16,662,972
<b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>	<b>\$ 19,285,019</b>
 <b>RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES:</b>	
Operating Income	\$ 1,500,335
<b>ADJUSTMENTS TO RECONCILE OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES:</b>	
(Increase)/Decrease in Loans Receivable	(1,746,228)
(Increase)/Decrease in Interest Receivable	(12,745)
(Increase)/Decrease in Long Term Investment	(672,119)
Increase/(Decrease) in Accounts Payable	67,860
Increase/(Decrease) in Bonds Payable	(795,000)
Increase/(Decrease) in Accrued Bond Interest Payable	23,967
Increase/(Decrease) in Cost of Bond Issuance Payable	(9,436)
Increase/(Decrease) in Due to Other Fund	(30,000)
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>\$ (1,673,366)</b>

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

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
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**NOTES TO THE FINANCIAL STATEMENTS**

For the Fiscal Year Ended June 30, 2007

**1. Summary of Significant Accounting Policies**

- A. Basis of Presentation.** The accompanying financial statements of the Nebraska Department of Environmental Quality (Department) - Drinking Water State Revolving Fund Program (Program) have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

The financial statements have been prepared primarily from accounts maintained by the State Accounting Administrator of the Department of Administrative Services (DAS) and the Trustee (Wells Fargo Bank, Iowa) for the State match bond accounts.

- B. Reporting Entity.** The Drinking Water State Revolving Fund Program is a program within the Department and is established under and governed by the Safe Drinking Water Act of the Federal Government and the Drinking Water State Revolving Fund Act of the State of Nebraska. The Department is a State agency established under and governed by the laws of the State of Nebraska. As such, the Department is exempt from State and Federal income taxes. The Program's management has considered all potential component units of the Program for which it is financially accountable, and other organizations which are fiscally dependent on the Program, or the significance of their relationship with the Program are such that exclusion would be misleading or incomplete. GASB has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body and (1) the ability of the Department to impose its will on that organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the Department.

As required by generally accepted accounting principles, these financial statements present the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program. No component units were identified. The Program is part of the primary government for the State of Nebraska's reporting entity.

- C. Fund Structure.** The Program's accounts are maintained in accordance with the principles of fund accounting to ensure compliance with limitations and restrictions placed on the use of resources available to it. Under fund accounting,

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
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**NOTES TO THE FINANCIAL STATEMENTS**

(Continued)

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

individual funds are established for the purpose of carrying on activities or attaining objectives in accordance with specific regulations, restrictions, or limitations. Each individual fund is a self-balancing set of accounts recording cash and other financial resources, together with liabilities and residual equities or balances, and changes therein. The Program on the State accounting system includes the following funds as identified in the Drinking Water State Revolving Fund Act:

- Drinking Water Facilities Fund – General Fund 10000, Federal Funds 48416, 48417, and 48418, and Bond Funds 68480, 68481, 68482, and 68483.
- Drinking Water Administration Fund – Cash Fund 28630.

These funds are used to account for revenues and expenses for loans and administrative expenses of the Program.

The activity of these State of Nebraska funds have been combined and reported as an enterprise fund, which under governmental GAAP is a proprietary fund type. This fund type reflects transactions used to account for those operations that are financed and operated in a manner similar to a private business. The accounting for the Fund's transactions in this manner is a requirement of the Environmental Protection Agency (EPA) as they and the Department has decided that the determination of revenues earned, expenses incurred, and/or net income is necessary to demonstrate the success of the Program and to assure the EPA the Program will be available in perpetuity as intended.

This fund classification differs from the classification used in the State of Nebraska's Comprehensive Annual Financial Report (CAFR). The CAFR classifies the Cash funds, Federal funds, and Bond funds as Special Revenue funds because the major source of revenue is Federal assistance.

- D. Measurement Focus, Basis of Accounting.** The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. An enterprise fund is accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation of the fund are included on the balance sheet. Enterprise fund operating statements present increases (i.e., revenues) and decreases (i.e., expenses) in net total assets.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
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**NOTES TO THE FINANCIAL STATEMENTS**

(Continued)

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

Enterprise funds utilize the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

In reporting the financial activity of its enterprise fund, the Program's management applied all applicable GASB pronouncements as well as the following pronouncements issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinion, and Accounting Research Bulletins of the Committee on Accounting Procedures.

- E. Cash and Cash Equivalents.** In addition to bank accounts and petty cash, this classification includes all short-term investments such as certificates of deposit, repurchase agreements, and U.S. treasury bills. These short-term investments may have original maturities (remaining time to maturity at acquisition) greater than three months; however, cash is available and is considered cash and cash equivalents for reporting purposes. These investments are stated at cost, which at June 30, 2007, approximates market. Banks pledge collateral, as required by law, to guarantee State funds held in time and demand deposits.

Cash and Cash equivalents are under the control of the State Treasurer or other administrative bodies as determined by law. All cash deposited with the State Treasurer is initially maintained in a pooled cash account. On a daily basis, the State Treasurer invests cash not needed for current operations with the State's Investment Council that maintains an operating investment pool for such investments. Interest earned on these investments is allocated to funds based on their percentage of the investment pool.

Amounts Held by Trustee are considered cash equivalents due to their liquid nature.

- F. Loans Receivables.** The State operates the Program as a direct loan program, whereby loans are made to communities. The entire Drinking Water Program is funded, on average, 83.33% from Federal capitalization grants and 16.67% from State matching funds. Loan funds are disbursed to the local agencies as they expend funds for the purposes of the loan. Interest is calculated from the date funds are advanced, and after the final disbursement has been made, the payment

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
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**NOTES TO THE FINANCIAL STATEMENTS**

(Continued)

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

schedule identified in the loan agreement is adjusted for the actual amounts disbursed, and accrued interest during the project period. The interest rates on loans range from 3% to 4% and the terms are between 5 to 20 years. Disadvantaged communities may have up to 30 years to repay. The current loans receivable amount was determined using the amount of principal payment due to the Program at June 30, 2007, which was collectible in fiscal year 2008.

No provisions were made for uncollectible accounts as all loans were current, and management believed all loans would be repaid according to the loan terms. There was a provision for the Program to intercept State aid to a community in default of its loan.

**G. Accounts Payable.** The Nebraska Information System (NIS) has the capability of showing the amount of accounts payable at any time. The amount shown at June 30, 2007, is the figure that was used for this amount.

**H. Restricted Net Assets.** When both restricted and unrestricted resources are available for use, it is the Department's policy to use restricted resources first, then unrestricted resources, as they are needed. Net assets are reported as restricted when they are held in a separate account that can be used to pay debt principal and interest only and cannot be used to pay other current liabilities.

**I. 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 at fiscal year end and revenues and expenditures during the reporting period. Actual results could differ from those estimates.

**2. Cash in State Treasury, Amounts Held by Trustee, and Long Term Investments**

**Cash in State Treasury.** Cash in State Treasury represents the cash balance as reflected on NIS. Investment of all available cash is made by the State Investment Officer on a daily basis, based on total bank balances. These funds are held in the State of Nebraska Operating Investment Pool (OIP), an internal investment pool. Additional information on the deposits and investments portfolio including investment policies, risks, and types of investments can be found in the State of Nebraska's CAFR for the fiscal year ended June 30, 2007. All funds of the Drinking Water State Revolving Fund Program were designated for investment during the fiscal year ended June 30, 2007. Amounts are allocated on a monthly basis based on average balances of all invested funds.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
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**NOTES TO THE FINANCIAL STATEMENTS**  
(Continued)

**2. Cash in State Treasury, Amounts Held by Trustee, and Long Term Investments**  
(Continued)

**Amounts Held by Trustee.** The Nebraska Investment Finance Authority (NIFA) (the “Issuer”) issues revenue bonds, the proceeds which are used by the Department to provide the 20% match requirements for the Department’s Federal Capitalization Grants (See Note 4, Bonds Payable, for more details on these bonds). Wells Fargo Bank Iowa, National Association, (Trustee), as trustee, establishes the appropriate accounts and invests the monies in accordance with the Bond Indenture. At June 30, 2007, the amount held by the trustee of \$7,640,876 was considered cash and cash equivalent and was stated at Fair Value, except for the amounts invested in GIC’s, where no readily ascertainable fair value was available. For this investment the Program manager received an estimate of fair value from the Trustee. The amount held by the Trustee consisted of the following:

	<u>Fair Value</u>
Cash	\$ 8,849
Money Market Account	4,329,130
Guaranteed Investment Contracts (GICs) in CDC Funding Corporation	<u>3,302,897</u>
Total	<u>\$ 7,640,876</u>

The amounts shown as cash and as a money market account above are deposits as defined by GASB. As such those deposits have custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, the Program’s deposits may be lost. The deposits held by the Trustee were uninsured and uncollateralized during and at the end of fiscal year 2007. The Program does not have a custodial credit risk policy for deposits.

The amounts held by the Trustee in GIC’s were investments as defined by GASB. The Trustee, in accordance with the Series 2000A Supplemental Bond Indenture invests funds in a private debt obligations fund, which is considered a debt security. This debt security has the following risks:

- **Credit Risk** - Credit risk is a risk that an issuer of debt securities or another counterparty to an investment transaction will not fulfill an obligation and is commonly expressed in terms of the credit quality rating issued by a national rating organization. The GIC fund was unrated by Standard & Poor’s Rating Group and Moody’s Investors Service Inc.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
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**NOTES TO THE FINANCIAL STATEMENTS**

(Continued)

**2. Cash in State Treasury, Amounts Held by Trustee, and Long Term Investments**  
(Continued)

- Custodial Credit Risk of Investments - Custodial credit risk for investments is the risk that in the event of the failure of a counterparty, the Program will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The GIC fund held by the Trustee was uninsured and held by and in the name of the Trustee, not in the name of the Program.
- Concentration of Credit Risk - When investments are concentrated in one issuer, this concentration represents heightened risk of potential loss. No specific percentage identifies when concentration risk is present. GASB has adopted a principle that governments should provide note disclosure when 5 percent of the total government investments are concentrated in any one issuer. The Program had 60% of its total investments in the GIC fund.

The Program does not have a custodial credit risk policy for debt securities.

**Long Term Investments.** The State Investment Officer invests the State's funds in accordance with Neb. Rev. Stat. Section 72-1239.01 and the prudent person rule. The Program's investments are in a Goldman Sach's Financial Square Treasury Obligation Fund. The Program's investment policy is governed by the tax regulatory agreement of each bond. The interest earnings from this fund are paid directly to the bond trustee, Wells Fargo, N.A. of Des Moines, Iowa.

The fair value of this investment at June 30, 2007, was \$2,189,839.

This investment was subject to the following risks:

- Credit Risk, as defined above - This fund was unrated by Standard & Poor's Rating Group and Moody's Investors Service Inc.
- Custodial Credit Risk of Investments, as defined above - Investment was uninsured, but was held in the name of the State of Nebraska.
- Interest Rate Risk - Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Duration is a measure of a debt investment's exposure to fair value changes arising from changes in interest rates. The Program fund's duration was .44 years.
- Concentration of Credit Risk, as defined above - The Program had 37% of its total investments in a Goldman Sach's Financial Square Treasury Obligation Fund.

The Program does not have a custodial credit risk policy for investments.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
DRINKING WATER STATE REVOLVING FUND PROGRAM

**NOTES TO THE FINANCIAL STATEMENTS**

(Continued)

**2. Cash in State Treasury, Amounts Held by Trustee, and Long Term Investments**  
(Concluded)

Additional information on the State of Nebraska's policies regarding the above investment risks can be found in the State of Nebraska's CAFR for the fiscal year ended June 30, 2007.

**3. Loans Receivable**

As of June 30, 2007, the Program had made loans to 102 communities of which 91 had outstanding balances totaling \$68,881,850. The outstanding balances of the ten communities with the largest loan balances, which represent 63.7% of the total loans, were as follows:

<u>Community</u>	<u>Outstanding Balance</u>
McCook	\$ 9,762,069
North Platte	8,028,566
Sidney	7,942,282
Blair	5,914,151
Kearney	3,942,696
Beaver Lake Association	3,076,170
Plattsmouth	1,556,964
South Sioux City	1,401,806
Norfolk	1,158,035
Arlington	1,118,865
Total	\$ 43,901,605

**4. Bonds Payable**

The State has entered into a special financing arrangement with NIFA, an independent instrumentality of the State exercising essential public functions, to provide matching funds for the State's Drinking Water Program. NIFA issues the bonds and the proceeds are held by the Trustee until they are needed by the Program for loan purposes. The Series 2000A, 2001A, 2002A, 2003A, 2004A, 2005A, and 2006A Bonds are limited obligations of NIFA, payable only from and secured only by the Trust Estate. The Series 2000A, 2001A, 2002A, 2003A, 2004A, 2005A, and 2006A Bonds are revenue bonds. The Series 2000A, 2001A, 2002A, 2003A, 2004A, 2005A, and 2006A Bonds shall not constitute a debt, liability, general obligation of the State, or a pledge of the faith and Credit of the State, but are payable solely out of the revenue or money NIFA pledged to

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
DRINKING WATER STATE REVOLVING FUND PROGRAM

**NOTES TO THE FINANCIAL STATEMENTS**

(Continued)

**4. Bonds Payable** (Concluded)

the Trust Estate. Neither the faith and credit nor the taxing power of the State is pledged for the payment of the principal of, premium, if any, or the interest on the Series 2000A, 2001A, 2002A, 2003A, 2004A, 2005A, and 2006A Bonds. The current bonds payable amount was determined using the amount of bond principal to be retired in fiscal year 2008. Bonds payable for the fiscal year ended June 30, 2007, is as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Retirement</u>	<u>Ending Balance</u>	<u>Current Portion</u>
Bonds Payable	\$ 14,600,000	\$ -	\$ 795,000	\$ 13,805,000	\$ 940,000

Bonds payable at June 30, 2007, consist of the following:

Series	Original Issue	Retirements	2007 Balance	Interest Rate	Final Maturity Date
2000A	\$ 5,530,000	\$ 1,505,000	\$ 4,025,000	4.8-5.7%	July 1, 2015
2001A	1,815,000	465,000	1,350,000	3.9-5.15%	July 1, 2016
2002A	2,000,000	430,000	1,570,000	1.8-4.6%	Jan. 1, 2017
2003A	1,700,000	290,000	1,410,000	1.3-3.8%	Jan. 1, 2018
2004A	1,890,000	190,000	1,700,000	1.6-4.26%	July 1, 2019
2005A	1,920,000	85,000	1,835,000	2.75-4.2%	July 1, 2020
2006A	1,915,000		1,915,000	3.6-4.3%	Jan. 1, 2021

The 2000A Series Bonds were issued June 29, 2000, the 2001A Series Bonds were issued March 28, 2001, the 2002A Series Bonds were issued December 19, 2002, the 2003A Series Bonds were issued June 19, 2003, the 2004A Series Bonds were issued September 16, 2004, the 2005A Series Bonds were issued August 15, 2005, and the Series 2006A Bonds were issued June 8, 2006. Bonds mature at various intervals through January 2021. The debt service requirements on bonds maturing in subsequent years are as follows:

Year Ending June 30	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2008	\$ 940,000	\$ 605,514	\$ 1,545,514
2009	985,000	568,465	1,553,465
2010	1,035,000	528,185	1,563,185
2011	1,070,000	484,700	1,554,700
2012	1,125,000	437,711	1,562,711
2013-2017	6,605,000	1,315,790	7,920,790
2018-2021	2,045,000	172,085	2,217,085
Total	<u>\$ 13,805,000</u>	<u>\$ 4,112,450</u>	<u>\$ 17,917,450</u>

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
DRINKING WATER STATE REVOLVING FUND PROGRAM

**NOTES TO THE FINANCIAL STATEMENTS**  
(Continued)

**5. Net Assets**

Included in the Net Assets is the total amount of capitalization grants drawn from the Environmental Protection Agency (EPA) by the Department. The following summarizes the EPA capitalization grants awarded, drawn, and the remaining balance as of June 30, 2007.

Year	Grant Amount	Amount Drawn	Balance
1997	\$ 12,824,000	\$ 12,824,000	\$ -
1998	7,121,300	7,121,300	-
1999	7,463,800	7,463,800	-
2000	7,757,000	7,757,000	-
2001	7,789,126	7,789,126	-
2002	8,052,500	8,052,500	-
2003	8,004,100	7,931,876	72,224
2004	8,303,100	8,086,530	216,570
2005	8,285,500	7,909,661	375,839
2006	8,229,300	3,218,751	5,010,549
<b>TOTAL</b>	<b>\$ 83,829,726</b>	<b>\$ 78,154,544</b>	<b>\$ 5,675,182</b>

The following is a summary of changes in the total contributed capital:

Contributed Capital July 1, 2006	\$ 76,187,967
Contributed During the Year Funds	
Received From EPA	4,295,413
Contributed Capital June 30, 2007	<u>\$ 80,483,380</u>

Also included in the Contributed Capital is a total of all general funds received by the Program from the Legislature of the State of Nebraska. These assets were to be used as match for the Program for the initial capitalization grant received by the State. The State contributed \$1,162,318 and \$1,166,518 in the fiscal years ended June 30, 1998, and 1999, respectively.

**6. Loan Fees Administration**

The reported amount comes from a fee charged to loan recipients each year based on the amount of the loan outstanding. The fee is 1% per annum and is collected semi-annually.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
DRINKING WATER STATE REVOLVING FUND PROGRAM

**NOTES TO THE FINANCIAL STATEMENTS**

(Continued)

**7. Interest on Fund Balance Long-Term Investments - State Operating Pool**

The reported amount represents the earnings the Program has received from idle funds invested by the Treasurer of the State of Nebraska. Interest is credited on approximately the twenty-fifth day of each subsequent month.

**8. Operating Revenues and Expenses**

Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the Program's principal ongoing operations. The principal operating revenue of the Program is the Loan Fees Administration. Interest revenues are also operating revenues since making loans is the primary purpose of the Program. The principal operating expenses of the Program are administration expenses and loan forgiveness. Interest expenses are also operating expenses since making loans is the primary purpose of the Program.

**9. Operating Expenses**

The Operating Expenses of the Drinking Water State Revolving Fund Program are classified, for financial reporting purposes, into seven categories. There are four set-aside activities established under Section 1452 of the Safe Drinking Water Act. The four set-aside activities are:

- 15% Source Water Assessment Program
- 4% Administration
- 2% Technical Assistance to Small Systems
- 10% Public Water Supply System

All are required to be federally funded. State match dollars can only be used for the purpose of providing loans to owners of Public Water Supply Systems. The other categories of expenses are 30% Loan Forgiveness, Interest Expense-State Match Bonds, and Cost of Bond Issuance.

Following is an explanation of each category:

**15% Source Water Assessment Program**

Identified in Federal regulations as local assistance and other state programs, the State may use up to 15% of the capitalization grant amount for specified uses as follows:

- Assistance to a public water system to acquire land or a conservation easement for source water protection purposes;

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
DRINKING WATER STATE REVOLVING FUND PROGRAM

**NOTES TO THE FINANCIAL STATEMENTS**

(Continued)

**9. Operating Expenses** (Continued)

- Assistance to a community water system to implement voluntary, incentive-based source water quality protection measures;
- Provide funding to delineate and assess source water protection areas;
- To support the establishment and implementation of wellhead protection programs; and
- To provide funding to a Public Water System to implement technical and/or financial assistance under the capacity development strategy.

4% Administration

A state may use up to 4 percent of the funds allotted to it for the reasonable costs of administering the program and providing technical assistance. These costs may include such activities as issuing debt; start up costs; audit costs; financial management; legal consulting fees; development of IUP (Intended Use Plan) and priority ranking system; development of affordability criteria; and costs of support services provided by other state agencies. If the state does not obligate the entire four-percent for administrative costs in one year, it can bank the excess balance and use it for administrative costs in later years. The administrative costs included in the 4% Administration category on the Statement of Revenues, Expenses, and Changes in Net Assets were not expenditures of Federal monies but were expended from loan fee revenues.

2% Technical Assistance to Small Systems

A state may use up to 2 percent of its allotment to provide technical assistance to public water systems serving 10,000 people or less. If the state does not use the entire 2 percent for these activities against a given allotment, it can bank the excess balance and use it for the same activities in later years. A state may use these funds to support a technical assistance team or to contract with outside organizations to provide technical assistance.

10% Public Water Supply System

A state may use up to 10 percent of its allotment to:

- Administer the State Public Water Supply System program;
- Administer or provide technical assistance through source water protection programs, which includes the Class V portion of the Underground Injection Control Program;
- Develop and implement a capacity development strategy; and
- Develop and implement an operator certification program.

30% Loan Forgiveness

The amount of expenses reported as Loan Forgiveness is the amount the State forgave loans to communities meeting the definition “disadvantaged” or, which the State expects

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
DRINKING WATER STATE REVOLVING FUND PROGRAM

**NOTES TO THE FINANCIAL STATEMENTS**

(Continued)

**9. Operating Expenses** (Concluded)

the Community to become disadvantaged as a result of the project. The amount of these subsidies during a particular fiscal year's capitalization grant cannot exceed 30 percent of the amount of the capitalization grant for that year.

The Nebraska Department of Health and Human Services is provided funding under the following set-asides: Administrative, Public Water Supply System, and Small Systems Technical Assistance. A Memorandum of Understanding was entered into between the Department and the Nebraska Department of Health and Human Services to provide support of the Program.

Interest Expense-State Match Bonds

The amount is interest paid to bond holders at the time bond principal was retired during the fiscal year.

**10. State Employee's Retirement Plan (Plan)**

The single-employer plan became effective by statute on January 1, 1964. Prior to January 1, 2003, the plan consisted of a defined contribution plan that covered State employees. Effective January 1, 2003, a cash balance benefit was added to the State Employees Retirement Act. The cash balance benefit is a type of defined benefit plan. Each member employed and participating in the retirement system prior to January 1, 2003, elected to either continue participation in the defined contribution option or begin participation in the cash balance benefit. The defined contribution option is closed to new entrants. All new members of the Plan on and after January 1, 2003, become members of the cash balance benefit. Additionally, on or after November 1, 2007, but before January 1, 2008, members who are employed and participating in the retirement system may either elect to continue participation in the defined contribution option or elect to participate in the cash balance benefit. Members who elect to participate in the cash balance benefit during this timeframe shall commence participation in the cash balance benefit on January 1, 2008. The benefits and funding policy of the Plan is established and can only be amended by the Nebraska Legislature.

Prior to January 1, 2007, all permanent full-time employees who had 12 continuous months of service were required to begin participation in the retirement system. All permanent full-time or permanent part-time employees who had 12 months of service within a five-year period, and who had attained the age of 20, could exercise the option to begin participation in the retirement system. As of January 1, 2007, all permanent full-time employees are required to begin participation in the retirement system upon employment; and all permanent part-time employees, who have attained the age of twenty years, may exercise the option to begin participation in the retirement system.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
DRINKING WATER STATE REVOLVING FUND PROGRAM

**NOTES TO THE FINANCIAL STATEMENTS**

(Continued)

**10. State Employee's Retirement Plan (Plan)** (Concluded)

**Contribution.** Prior to January 1, 2007, each member contributed 4.33% of his or her monthly compensation until \$864 had been contributed and 4.8% of his or her monthly compensation for the remainder of the calendar year. As of January 1, 2007, each member contributes 4.8% of his or her monthly compensation.

The Department matches the member's contribution at a rate of 156%. The employee's and employer's contributions are kept in separate accounts.

The employee's account is fully vested. The employer's account is vested 100% after a total of three years of participation in the system, including the credit for participation in another Nebraska governmental plan prior to actual contribution to the Plan.

**Defined Contribution Option.** Upon attainment of age 55, regardless of service, the retirement allowance shall be equal to the sum of the employee and employer account. Members have several forms of payment available, including withdrawals, deferrals, annuities, or a combination of these.

**Cash Balance Benefit.** Upon attainment of age 55, regardless of service, the retirement allowance shall be equal to the accumulated employee and employer cash balance accounts, including interest credits, annuitized for payment in the normal form. The normal form of payment is single life annuity with five year certain, payable monthly. Members will have the option to convert their member cash balance account to a monthly annuity with built in cost-of-living adjustments of 2.5% annually. Also available are additional forms of payment allowed under the Plan which are actuarially equivalent to the normal form, including the option of lump-sum or partial lump-sum.

For the fiscal year ended June 30, 2007, employees contributed \$9,767 and the Department contributed \$15,236. A separate plan report is issued and can be obtained from the Nebraska Public Employees Retirement System. This report contains full pension-related disclosures.

**11. Contingencies and Commitments**

**Risk Management.** The Department is exposed to various risks of loss related to torts, theft of, damage to, or destruction of assets, errors or omissions, injuries to employees, and natural disasters. The Department, as part of the primary government for the State, participates in the State's risk management program. The Nebraska Department of Administrative Services (DAS) Division of Risk Management is responsible for maintaining the insurance and self-insurance programs for the State with the exception of

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
DRINKING WATER STATE REVOLVING FUND PROGRAM

**NOTES TO THE FINANCIAL STATEMENTS**

(Continued)

**11. Contingencies and Commitments** (Continued)

the health and life insurance programs which are maintained by the DAS Personnel Division. The State generally self-insures for general liability and workers' compensation. The State has chosen to purchase insurance for:

- A. Motor vehicle liability, which is insured for the first \$5 million of exposure per accident with a self-insured retention of \$300,000 per accident, except for accidents involving vehicular pursuit which have a \$1,000,000 self-insured retention per accident. Insurance is also purchased for medical payments, physical damage, and uninsured and underinsured motorists with various limits and deductibles. State agencies have the option to purchase coverage for physical damage to vehicles.
- B. Health care and life insurance for eligible employees.
- C. Crime coverage, with a limit of \$21 million for each loss, and a \$25,000 self-insured retention per incident was in effect from July 1, 2006 through October 18, 2006. Starting October 19, 2006, the limit for each loss was increased to \$31 million.
- D. Real and personal property on a blanket basis for losses up to \$250,000,000, with a self-insured retention of \$200,000 per loss occurrence. Newly acquired properties are covered up to \$5,000,000 for 120 days or until the value of the property is reported to the insurance company. The perils of flood, earthquake, and acts of terrorism have various coverages, sublimits, and self insurance. Details of these coverages are available from DAS Risk Management Division. State agencies have the option to purchase building contents and inland marine coverage.

No settlements exceeded commercial insurance coverage in any of the past three fiscal years. Health care insurance is funded in the Insurance Trust Funds through a combination of employee and State contributions. Workers' compensation is funded in the Workers' Compensation Internal Service Fund through assessments on each agency based on total agency payroll and past experience. Tort claims, theft of, damage to, or destruction of assets, errors or omissions, and natural disasters would be funded through the State General Fund or by individual agency assessments as directed by the Legislature, unless covered by purchased insurance. No amounts for estimated claims have been reported in the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's financial statements.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
DRINKING WATER STATE REVOLVING FUND PROGRAM

**NOTES TO THE FINANCIAL STATEMENTS**

(Continued)

**11. Contingencies and Commitments** (Concluded)

**Litigation.** The potential amount of liability involved in litigation pending against the Department, if any, could not be determined at this time. However, it is the Department's opinion that final settlement of those matters should not have an adverse effect on the Department's ability to administer current programs. Any judgment against the Department would have to be processed through the State Claims Board and be approved by the Legislature.

**12. Reconciliation of Bank Records to the Nebraska Information System**

Through their bank reconciliation procedures, DAS State Accounting Division (State Accounting) has identified a large unknown statewide variance between the State Treasurer's bank statements and the State's balances in the general ledger. This unknown variance indicates the bank records are short as compared to the accounting records. Some adjustments to the accounting records may be needed and may affect the fund balances of the Department. At this time, it has not been determined how or when adjustments to the accounting records might be made. State Accounting is unable to determine the affect of such adjustment, if any, on the Department's balances; however, State Accounting believes it will not have a material impact on the Department's operations.



## NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
DRINKING WATER STATE REVOLVING FUND PROGRAM  
**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**

Nebraska Department of Environmental Quality  
Lincoln, Nebraska

We have audited the financial statements of the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program as of and for the year ended June 30, 2007, and have issued our report thereon dated March 25, 2008. The Independent Auditor's Report was modified to emphasize the financial statements present only the funds of the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program. 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 Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's internal control over financial reporting.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Nebraska Department of

Environmental Quality - Drinking Water State Revolving Fund Program's financial statements that is more than inconsequential will not be prevented or detected by the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

#### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's 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 management, the Department of Environmental Quality, others within the Department, and the appropriate Federal and regulatory agencies. However, this report is a matter of public record and its distribution is not limited.

Handwritten signature of Timothy J. Chamber CPA in black ink.

Assistant Deputy Auditor

March 25, 2008



## NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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**NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY  
DRINKING WATER STATE REVOLVING FUND PROGRAM  
REPORT ON COMPLIANCE AND ON INTERNAL CONTROL  
OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO  
THE NEBRASKA DEPARTMENT OF ENVIRONMENTAL  
QUALITY - DRINKING WATER STATE REVOLVING FUND  
PROGRAM IN ACCORDANCE WITH *U.S. ENVIRONMENTAL  
PROTECTION AGENCY AUDIT GUIDE FOR CLEAN WATER  
AND DRINKING WATER STATE REVOLVING FUND PROGRAMS***

Nebraska Department of Environmental Quality  
Lincoln, Nebraska

We have audited the compliance of the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program with the types of compliance requirements described in the *U.S. Environmental Protection Agency Audit Guide for Clean Water and Drinking Water State Revolving Fund Programs* that were applicable for the year ended June 30, 2007. We audited the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program’s compliance with requirements governing: Allowability for Specific Activities, Allowable Costs/Cost Principles, Cash Management, State Matching, Period of Availability of Funds and Binding Commitments, Program Income, Reporting, Subrecipient Monitoring, and Special Tests and Provisions. Compliance with these requirements is the responsibility of the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program’s management. Our responsibility is to express an opinion on the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program’s compliance based on our audit.

### Compliance

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the *U.S. Environmental Protection Agency Audit Guide for Clean Water and Drinking Water State Revolving Fund Programs*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on the Program occurred. An audit includes examining, on a test basis, evidence about the Nebraska Department of Environmental

Quality – Drinking Water State Revolving Fund Program’s compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program’s compliance with those requirements.

In our opinion, the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program complied, in all material respects, with the requirements referred to above that are applicable to the Program for the fiscal year ended June 30, 2007.

#### Internal Control Over Compliance

The management of the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants. In planning and performing our audit, we considered the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program’s internal control over compliance with requirements that could have a direct and material effect on the Program in order to determine our auditing procedures for the purpose of expressing an opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Department’s internal control over compliance.

A *control deficiency* in an entity’s internal control over compliance 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 noncompliance with a type of compliance requirement of a Federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity’s ability to administer a Federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a Federal program that is more than inconsequential will not be prevented or detected by the entity’s internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a Federal program will not be prevented or detected by the entity’s internal control.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of management, the Department of Environmental Quality, others within the Department, and the appropriate Federal and regulatory agencies. However, this report is a matter of public record and its distribution is not limited.

Handwritten signature of Timothy J. Channer CPA in black ink.

Assistant Deputy Auditor

March 25, 2008