AUDIT REPORT
OF THE
NEBRASKA DEPARTMENT OF
ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING
FUND PROGRAM

JULY 1, 2009 THROUGH JUNE 30, 2010

Issued on December 6, 2010

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. §§ 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, 2010, the EPA had awarded $108 million in capitalization grants to the State, plus $19.5 million in American Recovery and Reinvestment Act (ARRA) funds. The award of this $108 million required the State to contribute approximately $22 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 2000, $1,815,000 in March 2001, $2,000,000 in December 2002, $1,700,000 in June 2003, $1,890,000 in September 2004, $1,920,000 in August 2005, $1,915,000 in June 2006, $1,920,000 in September 2007, and $1,965,000 in October 2008. The 2009 Capitalization grant was matched with $1,629,000 of Administrative Cash Funds.

The Program is administered by the Nebraska Department of Environmental Quality (Department) and the Nebraska Department of Health and Human Services – Division of Public Health. 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 Department of Health and Human Services – Division of Public Health sets the funding priorities.

EXIT CONFERENCE

An exit conference was held November 10, 2010, with the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program to discuss the results of our examination. Those in attendance for the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program were:

NAME	**TITLE**
Tom Lamberson	Deputy Director
Martie Guthrie	Budget Officer III
Pat Rice	Assistant Director, Water Quality Division
Mark B. Herman	Compliance Specialist
Kris Young	Accountant III
Amy Wilson	State Accounting, Fixed Assets
Curtis Youngman	State Accounting, Federal Grants Auditor
Rick Bay	Financial Assistance Section Supervisor
Steven McNulty	Environmental Engineer II, DHHS

SUMMARY OF COMMENTS

During our audit of the Nebraska Department of Environmental Quality (Agency) - Drinking Water State Revolving Fund Program, we noted certain matters involving the internal control over financial reporting and other operational matters that are presented here.

1. ***Financial Statement Errors:*** Errors were noted in the financial information prepared by the Agency's accounting staff and were also noted on the trial balances prepared by the Agency. Trial balance amounts are carried forward to the financial statements.

2. ***Loan Testing:*** Documentation of loan files could be improved.

3. ***Reporting:*** Certain Federal reports were not filed with the EPA and control procedures over reports could be improved.

4. ***20% State Match Requirements:*** State match was not deposited into the Fund before Federal funds were drawn.

More detailed information on the above items is provided hereafter. It should be noted this report is critical in nature since it contains only our comments and recommendations on the areas noted for improvement.

Draft copies of this report were furnished to the Agency to provide them an opportunity to review the report and to respond to the comments and recommendations included in this report. All formal responses received have been incorporated into this report. Responses have been objectively evaluated and recognized, as appropriate, in the report. Responses that indicate corrective action has been taken were not verified at this time, but will be verified in the next audit.

We appreciate the cooperation and courtesy extended to our auditors during the course of the audit.

COMMENTS AND RECOMMENDATIONS

1. Financial Statement Errors

Sound accounting practice and a good internal control plan require financial information and report disclosures to be complete and accurate. The accounting staff should have an understanding of all entries and supporting documentation for all numbers included on the financial statements. Sound accounting practice further requires correct calculations of data included in the financial information. Good internal controls also require that pre-audit procedures be in place to ensure expenditure coding is correct for fund, object account, and business unit.

Numerous errors were noted on the trial balances prepared by the Nebraska Department of Environmental Quality (Agency) and provided to us for the Drinking Water State Revolving Fund (DWSRF). The trial balance financial information originally provided to us did not balance between the Balance Sheet and the Statement of Revenues, Expenses, and Changes in Net Assets. During our review of the financial data it was determined two main reasons for this seem to be there was not a regular accounting for the transactions in the DWSRF bond account and transactions in the State accounting systems were not always recorded correctly and errors, when made, were not detected in a timely manner. For example, an error in recording a loan receivable of $974,179 was made in EnterpriseOne (E1-the State's accounting system) on May 25, 2010, which went undetected by the Agency. The loan receivable transaction recorded in E1 in error resulted in cash being overstated by $974,179 in the Clean Water State Revolving Fund (CWSRF) and understated by $974,179 in the DWSRF. This undetected error, in large part, was the reason for the financial statements for the DWSRF not balancing.

During our fiscal year ended June 30, 2009, audit the Auditor of Public Accounts (APA) reported similar problems that the Agency had in the preparation of the financial statements for the DWSRF accrual basis financial statements. The DWSRF fiscal year ended June 30, 2009, report was not issued until June 2, 2010. At that time the Agency responded to our comment as follows: *During the period of this audit report, NDEQ experienced a changeover of key financial personnel who were responsible for revolving fund transactions and reporting. New personnel took over these duties with minimal cross training, and were required to find documentation for transactions they had not previously been responsible for under tight timeframes. Management recognizes the importance of accurate, timely and complete financial statement presentation. We have taken steps to ensure reconciliations of general ledger accounts are done on a regular basis and documented with adequate supporting explanations. Additional financial staff are involved in the financial statement preparation and reconciliation of accounts to provide good internal control, cross training of personnel, and accurate statement presentation in the future.*

In the short time since the fiscal year ended June 30, 2009, report was issued the APA believes the Agency's staff has made strides in understanding and preparing accrual basis statements for DWSRF. However, ensuring staff understand financial transactions and ensuring those transactions are recorded accurately in E1, performing a regular reconciliation of the DWSRF

COMMENTS AND RECOMMENDATIONS
(Continued)

1. <u>Financial Statement Errors</u> (Concluded)

bond account and ensuring a sound understanding of the worksheets used to prepared the DWSRF accrual basis financial statement trial balances would further enhance the Agency's ability to prepare annual accrual financial statements for the DWSRF as required by the Environmental Protection Agency (EPA).

The financial statements were adjusted for the errors noted.

Without strong internal control procedures to ensure financial information is complete, accurate, and in accordance with accounting standards, there is a risk of misstated financial statements.

> We recommend the Agency develop procedures to ensure transactions are recorded correctly in E1 and that accounting staff continue to work on understanding those financial transactions and understanding the worksheets used to prepare the accrual financial statement trial balances for the DWSRF. In addition, we recommend the Agency develop procedures to regularly reconcile the DWSRF bond account to help ensure all bond transactions are recorded in the preparation of the annual accrual financial statements.

Management Response: NDEQ Management recognizes the importance of accurate, timely and complete financial statement presentation.

Corrective Action Plan: We have taken steps to ensure reconciliations of general ledger accounts are done on a regular basis and documented with adequate supporting explanations. Additional financial staff are involved in the financial statement preparation and reconciliation of accounts to provide good internal control, cross training of personnel, and accurate statement presentation in the future.

A mid-year trial balance and financial statements will be prepared to aid in the accuracy of general ledger activities and help provide additional training to involved staff.

Contact: Martie Guthrie, Budget Officer III

Anticipated Completion Date: February 1, 2011, for mid-year trial balance and financial statements. Reconciliations, cross training, internal controls is ongoing.

COMMENTS AND RECOMMENDATIONS
(Continued)

2. Loan Testing

Program: CFDA 66.468 – Capitalization Grants for Drinking Water State Revolving Fund (DWSRF) and ARRA – Subrecipient Monitoring, Davis-Bacon Act, Procurement, and Suspension and Debarment

Grant Number & Year: All open grants, including FS-99780509 and 2F-97705601

Federal Grantor Agency: U.S. Environmental Protection Agency (EPA)

Criteria: 2 C.F.R. § 176.210(c) (April 23, 2009) states, "Recipients agree to separately identify to each subrecipient, and document at the time of subaward and at the time of disbursement of funds, the Federal award number, CFDA number, and amount of Recovery Act funds. When a recipient awards Recovery Act funds for an existing program, the information furnished to subrecipients shall distinguish the subawards of incremental Recovery Act funds from regular subawards under the existing program."

2 C.F.R. § 176.210(d) (April 23, 2009) states, "Recipients agree to require their subrecipients to include on their SEFA information to specifically identify Recovery Act funding similar to the requirements for the recipient SEFA described above. This information is needed to allow the recipient to properly monitor subrecipient expenditure of ARRA funds as well as oversight by the Federal awarding agencies, Offices of Inspector General and the Government Accountability Office."

A good internal control plan requires procedures be in place to:

- complete a loan award checklist for every project to ensure all administrative and mailing procedures have been completed for all loans awarded,
- complete a documented review of the monthly payroll certifications by the project engineer,
- complete a documented review of the specifications to ensure current wage rates, and
- adequately monitor subrecipients' compliance with Federal requirements, including not doing business with suspended or debarred parties, and for ARRA funds, Buy-American procurement policies.

Condition: Documentation of loan files could be improved.

Questioned Costs: Unknown

Context: During testing it was noted:

- For 4 of 15 loans tested, the loan award checklist was not on file.
- For 4 of 4 loans tested, the review of monthly payroll certifications by the project engineer was not documented. (Davis-Bacon Act)
- For 4 of 4 loans tested, the review of specifications for current wage rates was not documented. (Davis-Bacon Act)

COMMENTS AND RECOMMENDATIONS
(Continued)

2. <u>Loan Testing</u> (Continued)

- For 4 of 4 loans tested, there was no documentation to support subrecipient monitoring of suspended and debarred entities and Buy-American procurement policies. (Suspension and Debarment)
- For 15 of 15 loans tested, the Agency did not separately identify the CFDA number and title, the award name and number at the time of the subaward and disbursement of funds; and for ARRA funding, did not identify the requirement for subrecipients to provide appropriate identification of ARRA funds in their SEFA and SF-SAC. (Subrecipient Monitoring)

Cause: Unknown

Effect: There is an increased potential for noncompliance with Agency Rules and Regulations as well as Federal grant compliance requirements.

Recommendation: We recommend the following:

- A loan award checklist is completed for every loan that is awarded.
- Procedures be improved to ensure documentation is maintained to support a review of:
  - monthly payroll certifications,
  - current wage rate specifications,
  - subrecipient monitoring of suspended and debarred entities,
  - Buy-American procurement policies.
- The Agency separately identify the CFDA number and title, the award name and number at the time of the subaward for all grants and additionally for ARRA funding at the time of disbursement of funds. In addition, for ARRA funding, identify the requirement for subrecipients to provide appropriate identification of ARRA funds in their SEFA and SF-SAC.

Management Response: NDEQ Management recognizes the importance of a good internal control plan for loan processing and monitoring, to ensure necessary steps are completed, as well as compliance with Federal regulations are documented and fulfilled.

Corrective Action Plan: The Agency has begun modification of our internal control plan to implement the suggested recommendations. The Agency has reinstituted a comprehensive loan award checklist for every project. Subrecipient compliance with all Federal requirements will continue to be monitored and documented. Project engineers will initial their reviews of monthly payroll certifications and will document current wage rate compliance during the initial review of specifications and during on-site project inspection visits.

Due to the fluid nature of construction projects, the award name and number at the time of the subaward for all grants may need to be adjusted at the time of disbursement but will be recorded and documented accordingly.

COMMENTS AND RECOMMENDATIONS
(Continued)

2. Loan Testing (Concluded)

Contact: Pat Rice, Water Quality Division Assistant Director
Rick Bay, Section Supervisor, Water Quality Financial Assistance Section

Anticipated Completion Date: January 1, 2011

3. Reporting

Program: CFDA 66.468 – Capitalization Grants for Drinking Water State Revolving Fund (DWSRF) ARRA – Reporting

Grant Number & Year: #2F-97705601 (FFY 2009)

Federal Grantor Agency: U.S. Environmental Protection Agency (EPA)

Criteria: The ARRA grant agreement requires "an Interim Financial Status Report (FSR) is to be submitted to the appropriate EPA Grants Management Office 90 days after the anniversary of the project period start date." Also, a good internal control plan includes a process to ensure the data reported on Federal financial reports agree to financial records and that an adequate supervisory review is documented prior to submission of the report.

Condition: The Nebraska Department of Environmental Quality (Agency) did not submit a FSR for the ARRA grant for the period ended October 1, 2009. It was also noted the Agency did not reconcile amounts reported on the ARRA 1512 Report to accounting records. It was further noted there was no documented supervisory review of the ARRA 1512 Report or the annual report submitted to the EPA.

Questioned Costs: Unknown

Context: Historically, the EPA has not required FSRs for the capitalization grants to be submitted until the close of the grant period. However, for the ARRA grant there is a requirement for an annual FSR. Another requirement for the ARRA grant is that an ARRA 1512 Report is submitted quarterly. The ARRA 1512 reports were submitted; however, the amounts reported were not reconciled to the accounting records. The capitalization grants also require an annual report be filed with the EPA. These annual reports were submitted; however, there was no documented supervisory review of the report.

Cause: Unknown

Effect: There is potential noncompliance with Federal regulations and an increased risk of incorrect reporting.

COMMENTS AND RECOMMENDATIONS
(Continued)

3. Reporting (Concluded)

Recommendation: We recommend the Agency improve reporting procedures to:

- submit annual FSRs for the ARRA grant,
- reconcile amounts reported on Federal reports, such as the ARRA 1512 Report, to accounting records, and
- document a supervisory review of all reports prior to submission.

Management Response: Management recognizes the importance of timely filing of required reports, as well as documented reconciliation of submitted numbers to accounting records.

Corrective Action Plan: Annual 10/1/09 and 10/1/10 Interim Federal Financial Reports (FFR) for the DWSRF ARRA grant have been filed with the EPA. The FFR filed has the signature of Martie Guthrie, Budget Officer III, who has verified the information reported reconciles to the State Accounting system.

The 1512 report information is reconciled to the State Accounting system and provided to programs for reporting by Martie Guthrie, Budget Officer III. The program inputs the information onto NE.gov. The 1512 reporting statistics are specifically reviewed by State Accounting staff and the EPA prior to the final posting date. Any information that is questioned is reviewed and changed if necessary. The 1512 report will also be reviewed, and approval documented by Rick Bay, Section Supervisor, Water Quality Financial Assistance Section.

Contact: Martie Guthrie, Budget Officer III

Anticipated Completion Date: Completed

APA Response: The Agency's response to our comment and recommendation noted above indicated: "The 1512 report information is reconciled to the State Accounting system and provided to programs for reporting by Martie Guthrie, Budget Officer III." They also noted: "The 1512 reporting statistics are specifically reviewed by State Accounting staff and the EPA prior to the final posting date." The Agency prepares its 1512 report from a separate record-keeping system specifically designed for the program and there was no reconciliation between the 1512 report prepared from this system and amounts recorded in the State Accounting System. As a result there was an error in the 1512 report in the amount of $212,136 as submitted by the Agency. We believe a reconciliation between the Agency's separate record-keeping system for the program and the State Accounting System would have caught this error. We understand this error was detected by State Accounting staff, not by Agency staff. Controls to ensure accurate 1512 reporting should be performed at the Agency before it is submitted to State Accounting and the EPA.

COMMENTS AND RECOMMENDATIONS
(Continued)

4. 20% State Match Requirements

Program: CFDA 66.468 – Capitalization Grants for Drinking Water State Revolving Fund (DWSRF) – Matching

Grant Number & Year: #FS-9970509 (FFY 2009)

Federal Grantor Agency: U.S. Environmental Protection Agency (EPA)

Criteria: 40 C.F.R. 35.3550(g)(2) (July 1, 2009) requires "a State must deposit the match into the Fund on or before the date that a State receives each payment for the capitalization grant."

Condition: The Nebraska Department of Environmental Quality (Agency) did not deposit the 20% State match into the DWSRF trust fund on or before they received the first payment for the capitalization grant.

Questioned Costs: Not Applicable

Context: The State match was met with three journal entries to transfer money from the cash fund (28630) to the trust fund (68483) for reimbursement payments to communities totaling $1,629,200 made during the period March 24, 2010, through April 13, 2010. However the first drawdown of the Federal grant was February 17, 2010.

Cause: Unknown

Effect: There is an increased risk of noncompliance with Federal regulations.

Recommendation: We recommend the Agency ensure the State match is deposited in accordance with 40 C.F.R. 35.3550(g)(2) as noted above.

> **Management Response:** The 20% State Match for the 2009 capitalization grant was met with administrative cash funds and therefore had no bearing on the trust fund (as it would, had the match been met by bonding). Capitalization grant match is an allowable use of the administrative cash funds. While management agrees the segregation of the 20% cash match would be prudent, in the agencies opinion, we had match funds on hand in the program funds in order to allow the Agency to begin expending the 2009 capitalization grant funds at the time they began to be paid out.
>
> **Corrective Action Plan:** The Agency will take note to segregate the cash match funds in a separate administration fund in the future, should we choose to cash match a grant again.
>
> **Contact:** Martie Guthrie, Budget Officer III
>
> **Anticipated Completion Date:** Completed

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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, as of and for the year ended June 30, 2010, which collectively comprise the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's basic financial statements as listed in the Table of Contents. These basic financial statements are 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 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, 2010, 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, 2010, 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 November 10, 2010, 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 November 10, 2010, 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 Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund 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. 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 it.

Signed Original on File

November 10, 2010

Don Dunlap, CPA
Assistant Deputy Auditor

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

This section of the Nebraska Department of Environmental Quality (Agency) - 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, 2010. This analysis has been prepared by management of the Department, and is intended to be read in conjunction with the Program's 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 are an integral part of the financial statements and provide 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, 2010, net assets of the Program increased by 25%. Revenues for the Program increased 2% while expenses increased by 370% due to ARRA principal forgiveness.

NET ASSETS

	2010	2009	% Change
Current Assets	$ 48,078,694	$ 44,102,743	9%
Noncurrent Assets	80,611,326	63,068,337	28%
Total Assets	128,690,020	107,171,080	20%
Current Liabilities	1,619,054	1,603,902	1%
Noncurrent Liabilities	13,110,000	14,405,000	(9%)
Total Liabilities	14,729,054	16,008,902	(8%)
Net Assets:			
Restricted	1,968,875	1,968,875	-%
Unrestricted	111,992,091	89,193,303	26%
Total Net Assets	$ 113,960,966	$ 91,162,178	25%

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

	2010	2009	% Change
Loan Fees Administration	$ 732,680	$ 716,611	2%
Interest	3,440,707	3,356,248	3%
Total Operating Revenues	4,173,387	4,072,859	2%
Administration	2,371,214	1,770,039	34%
Bond Expenses	660,133	681,194	(3%)
ARRA Principal Forgiveness	8,481,804	-	100%
Total Operating Expenses	11,513,151	2,451,233	370%
Operating Income	(7,339,764)	1,621,626	(553%)
Capital Federal Grants	14,422,710	4,924,230	193%
Capital Contributions ARRA Grants	15,715,842	-	100%
Change in Net Assets	22,798,788	6,545,856	248%
Net Assets, Beginning of Year	91,162,178	84,616,322	8%
Net Assets, End of Year	$ 113,960,966	$ 91,162,178	25%

The most significant changes from the fiscal year ended June 30, 2009, to the fiscal year ended June 30, 2010, were the Noncurrent Assets balance, Change in Net Assets and the amount received from Capital Contributions. The American Recovery and Reinvestment Act (ARRA) funds received by the agency of $15.7 million permitted additional community loans to be made. It also added a principal forgiveness component totaling $8.5 million, which increased operating expenses. 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.

ECONOMIC OUTLOOK

Nebraska's economy has been affected by the current national economic decline and Nebraska's economy has and will likely continue to impact the future net revenues of the State. Tax revenues continue to fall short of projections. How the Program's revenue will be affected by the current national economic decline and market freefall is unknown. The Program is included in the American Recovery and Reinvestment Act of 2009. The Drinking Water State Revolving Fund received $19.5 million in additional grants to be used for community loans. The ARRA funding does not require a State match.

Having higher rates on loan repayment and lower interest rates on new loans may contribute to lower revenues. A larger State investment pool balance and more total dollars of loans may contribute to offsetting lower revenues.

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

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 in the Net Assets section. See the Notes to the Financial Statements for more detailed information on the Bonds Payable, which represents the Fund's long-term debt activity for the year.

AMERICAN RECOVERY AND REINVESTMENT ACT

The Nebraska State Drinking Water Revolving Fund Program received $19.5 million in American Recovery and Reinvestment Act (ARRA) funding for upgrades to public water systems. ARRA provides new, one-time funding, which is combined with existing funds from the Drinking Water State Revolving Fund. The Nebraska Department of Health and Human Services (DHHS) Division of Public Health sets the funding priorities.

Fifty percent of the ARRA funding is made available in the form of low-interest loans to communities at 3 percent. The remaining fifty percent is issued as principal forgiveness per ARRA guidelines. Due to the fact that regular SRF capitalization grant funds were used as supplements to most of the ARRA projects, the average ARRA funded projects were made up of 75 percent loans and 25 percent principal forgiveness.

DHHS ranked the State's public water supply needs using the fund's established ranking system, with some modifications made to direct funds to projects that were further along in the planning stages. ARRA requires 20 percent of recovery funds go to water efficiency projects, such as water meter installation.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

BALANCE SHEET

June 30, 2010

		Enterprise Fund
ASSETS		
CURRENT ASSETS		
Cash and Cash Equivalents:		
Cash in State Treasury (Note 2)	$	28,365,005
Amounts Held by Trustee (Note 2)		12,447,166
Interest Receivable		99,650
Loans Receivable (Note 3)		7,166,873
TOTAL CURRENT ASSETS		48,078,694
NON-CURRENT ASSETS		
Loans Receivable (Note 3)		80,611,326
TOTAL NON-CURRENT ASSETS		80,611,326
TOTAL ASSETS	$	128,690,020
LIABILITIES		
CURRENT LIABILITIES		
Accrued Bond Interest Payable	$	324,054
Bonds Payable (Note 4)		1,295,000
TOTAL CURRENT LIABILITIES		1,619,054
NON-CURRENT LIABILITIES		
Bonds Payable (Note 4)		13,110,000
TOTAL NON-CURRENT LIABILITIES		13,110,000
TOTAL LIABILITIES		14,729,054
NET ASSETS		
Restricted for Bond Payments		1,968,875
Unrestricted		111,992,091
TOTAL NET ASSETS		113,960,966
TOTAL LIABILITIES AND NET ASSETS	$	128,690,020

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, 2010

		Enterprise Fund
OPERATING REVENUES:		
Loan Fees Administration (Note 6)	$	732,680
Interest on Loans		2,158,458
Interest on Fund Balance - Trustee		367,817
Interest on Fund Balance - State Operating Investment Pool (Note 7)		914,432
TOTAL OPERATING REVENUES		4,173,387
OPERATING EXPENSES:		
Administration From Fees (Note 9)		522,862
4% Administrative Costs from Grant		11,181
15% Source Water Assessment Program (Note 9)		580,011
2% Technical Assistance to Small Systems (Note 9)		215,490
10% Public Water Supply System (Note 9)		478,803
30% Loan Forgiveness (Note 9)		445,841
50% Principal Forgiveness ARRA (Note 9)		8,481,804
Bond Rebate Fee Expense		117,026
Interest Expense - State Match Bonds (Note 9)		660,133
TOTAL OPERATING EXPENSES		11,513,151
OPERATING INCOME		(7,339,764)
CAPITAL CONTRIBUTIONS - FEDERAL GRANTS		14,422,710
CAPITAL CONTRIBUTIONS - ARRA FEDERAL GRANTS		15,715,842
CHANGE IN NET ASSETS		22,798,788
TOTAL NET ASSETS, BEGINNING OF YEAR		91,162,178
TOTAL NET ASSETS, END OF YEAR	$	113,960,966

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

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM
STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2010

	Enterprise Fund
CASH FLOWS FROM OPERATING ACTIVITIES:	
Receipts From Customers	$ 8,446,580
Interest on Investments	1,261,614
Payments to Borrowers	(16,086,608)
Payments to Borrowers ARRA	(7,234,040)
Payments for Administration	(534,043)
15% Source Water Assessment Program	(580,011)
2% Technical Assistance to Small Systems	(215,490)
10% Public Water Supply System	(478,803)
Loan Forgiveness	(445,841)
Principal Forgiveness ARRA	(8,481,804)
Bond Principal Payments	(1,255,000)
Bond Interest Payments	(684,981)
Bond Rebate	(117,026)
NET CASH PROVIDED BY OPERATING ACTIVITIES	(26,405,453)
CASH FLOWS FROM NON-CAPITAL & RELATED FINANCING ACTIVITIES:	
Funds Received From the Environmental Protection Agency	14,422,710
ARRA Funds Received From the Environmental Protection Agency	15,715,842
NET CASH FROM NON-CAPITAL & RELATED FINANCING ACTIVITIES	30,138,552
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	37,079,070
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 40,812,169
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES:	
Operating Income	$ (7,339,764)
ADJUSTMENTS TO RECONCILE OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES:	
(Increase)/Decrease in Loans Receivable	(17,765,204)
(Increase)/Decrease in Interest Receivable	(20,635)
Increase/(Decrease) in Bonds Payable	(1,255,000)
Increase/(Decrease) in Accrued Interest on Bonds	(24,848)
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ (26,405,451)

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

NOTES TO THE FINANCIAL STATEMENTS

For the Fiscal Year Ended June 30, 2010

1. Summary of Significant Accounting Policies

A. Basis of Presentation

The accompanying basic 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 basic 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, individual funds are established for the

1. Summary of Significant Accounting Policies (Continued)

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 Funds – General Fund 10000, Federal Funds 48416, 48417, and 48418, and Bond Funds 68480, 68481, 68482, 68483, and 68484.

- 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 Program's transactions in this manner is a requirement of the Environmental Protection Agency (EPA) as they and the Department have 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 total net assets.

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 Opinions, 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, 2010, 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 Receivable

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, except American Recovery and Reinvestment Act (ARRA) funds. ARRA funds do not require 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 the funds are advanced, and after the final disbursement has been made, the payment 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 2.0% to 4.3% and the terms are

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

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, 2010, which is collectible in fiscal year 2011.

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. 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.

H. 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 expenses during the reporting period. Actual results could differ from those estimates.

2. **Cash in State Treasury and Amounts Held by Trustee**

Cash in State Treasury as reported on the balance sheet is under the control of the Nebraska State Treasurer or other administrative bodies as determined by law. 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, 2010. All interest revenue is allocated to the general fund except allocations required by law to be made to other funds. All funds of the Drinking Water State Revolving Fund Program were designated for investment during fiscal year 2010. Amounts are allocated on a monthly basis based on average balances of all invested funds.

2. Cash in State Treasury and Amounts Held by Trustee (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, 2010, the amount held by the Trustee of $12,447,166 was considered cash and cash equivalents and was stated at fair value, except for the amounts invested in Guaranteed Investment Contracts (GICs), 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:

	Fair Value
Cash	$ 2,279
Money Market Account	6,836,789
Guaranteed Investment Contracts (GICs) in CDC Funding Corporation	5,608,098
TOTAL	$ 12,447,166

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. Of the $6,839,068 in deposits held by the Trustee, $250,000 was covered by FDIC insurance and $6,589,068 was uninsured and uncollateralized during and at the end of the fiscal year ended June 30, 2010, and thus exposed to custodial credit risk. The Program does not have a custodial credit risk policy for deposits.

The Program monies identified in this section are held and invested by the Trustee in its capacity as trustee for the bonds as specified in the Master Trust Indenture Section 5.07 dated as of June 1, 2000. That document defines "Investment Obligations" as:

(a) direct obligations of, or obligations the prompt payment of principal and interest on which are fully guaranteed by, the United States of America;

(b) bonds, debentures, notes or other evidences of indebtedness issued or fully insured or guaranteed by any agency or instrumentality of the United States of America which is backed by the full faith and credit of the United States of America;

2. <u>Cash in State Treasury and Amounts Held by Trustee</u> (Continued)

(c) interest-bearing time or demand deposits, certificates of deposit or other similar banking arrangements with any Depository (including the Trustee), provided that such deposits, certificates and other arrangements are fully insured by the Federal Deposit Insurance Corporation or secured by obligations described in clauses (a) to (b), inclusive, of this definition, or a combination thereof;

(d) money market funds or similar fund which invests exclusively in obligations described in clause (a), (b), or (e) of this definition, or a combination thereof;

(e) bonds, debentures, notes or other evidences of indebtedness issued by any state of the United States of America or any political subdivision thereof or any public authority of body or instrumentality thereof which constitute obligations described in Section 103(a) of the Code which have a fixed par value and a fixed amount due at maturity and on call dates and are either rated "MIG 1" by Moody's and rated "SP-1+" by Standard & Poor's for short-term obligations or rated no lower than the rating on the Outstanding Bonds by Standard & Poor's and by Moody's;

(f) any repurchase agreement or similar financial transaction with a national banking association (including the Trustee), a bank or trust company organized under laws of any state, or a government bond dealer reporting to, trading with, and recognized as a primary dealer by the Federal Reserve Bank of New York or other corporation, association or entity which has a long-term debt rating by Standard & Poor's and Moody's no lower than the rating on the Outstanding bond, which agreement is secured by a perfected security interest in any one or more of the securities described in clause (a) or (b) and which have an aggregate market value at least equal to the amount invested;

(g) investment contracts issued, secured or guaranteed by a corporation (or its guarantor), a national banking association or a state banking association which has a long-term debt rating by Standard & Poor's and Moody's no lower than the rating on the Outstanding Bonds, or by a foreign bank or a United State branch or agency of a foreign bank, which foreign bank consents to in personam jurisdiction and which has a long-term debt rating by Standard & Poor's and Moody's no lower than the rating on the Outstanding Bonds; or

(h) obligations of an insurance company which has a long-term debt rating by Standard & Poor's and Moody's no lower than the rating on the Outstanding Bonds.

2. Cash in State Treasury and Amounts Held by Trustee (Concluded)

The amounts held by the Trustee in GICs 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.

- 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% of the total government investments are concentrated in any one issuer. The Program had 100% of its total investments in the GIC fund.

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

3. Loans Receivable

As of June 30, 2010, the Program had 115 outstanding balances totaling $87,778,199. The outstanding balances of the ten communities with the largest loan balances, which represents 60% of the total loans, were as follows:

3. Loans Receivable (Concluded)

City	Outstanding Balance
Kearney	$ 9,667,606
McCook	8,125,585
North Platte	6,910,448
Sidney	6,357,979
Metropolitan Utilities Dist	4,925,541
Gering	4,572,086
Blair	3,997,054
Alliance	3,256,873
Beaver Lake Association	2,702,960
Broken Bow	1,723,833
TOTAL	$ 52,239,965

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, 2006A, 2007A, and 2008A Bonds are limited obligations of NIFA, payable only from and secured only by the Trust Estate. The Series 2000A, 2001A, 2002A, 2003A, 2004A, 2005A, 2006A, 2007A, and 2008A Bonds are revenue bonds. The Series 2000A, 2001A, 2002A, 2003A, 2004A, 2005A, 2006A, 2007A, and 2008A 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 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, 2006A, 2007A, and 2008A Bonds. The current bonds payable amount was determined using the amount of bond principal to be retired in fiscal year 2010. Bonds payable for the fiscal year ended June 30, 2010, is as follows:

	Beginning Balance	Additions	Retirement	Ending Balance	Current Portion
Bonds Payable	$ 15,660,000	$ -	$ 1,255,000	$ 14,405,000	$ 1,295,000

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

4. Bonds Payable (Concluded)

Bonds payable at June 30, 2010, consist of the following:

Series	Original Issue	Retirements	2010 Balance	Interest Rate	Final Maturity Date
2000A	$ 5,530,000	$ 2,485,000	$ 3,045,000	4.8-5.7%	July 1, 2015
2001A	1,815,000	795,000	1,020,000	3.9-5.15%	Jan. 1, 2016
2002A	2,000,000	790,000	1,210,000	1.8-4.6%	Jan. 1, 2017
2003A	1,700,000	595,000	1,105,000	1.3-3.8%	Jan. 1, 2018
2004A	1,890,000	525,000	1,365,000	1.6-4.75%	July 1, 2019
2005A	1,920,000	405,000	1,515,000	2.75-4.2%	July 1, 2020
2006A	1,915,000	330,000	1,585,000	3.6-4.3%	Jan. 1, 2021
2007A	1,920,000	215,000	1,705,000	3.5-4.35%	Jan. 1, 2022
2008A	1,965,000	110,000	1,855,000	2.75-5.0%	Jan. 1, 2023

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, the Series 2006A Bonds were issued June 8, 2006, the Series 2007A Bonds were issued September 28, 2007, and the Series 2008A Bonds were issued October 3, 2008. Bonds mature at various intervals through January 2023. The debt service requirements on bonds maturing in subsequent years are as follows:

Year Ending June 30	Principal	Interest	Total
2011	$ 1,295,000	$ 634,565	$ 1,929,565
2012	1,360,000	580,084	1,940,084
2013	1,410,000	521,223	1,931,223
2014	1,465,000	458,485	1,923,485
2015	1,515,000	391,319	1,906,319
2016-2020	6,145,000	892,658	7,037,658
2021-2023	1,215,000	87,215	1,302,215
TOTAL	$ 14,405,000	$ 3,565,549	$ 17,970,549

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

5. Net Assets

Included in the Net Assets is the total amount of capitalization grants drawn from the EPA by the Agency. The following summarizes the EPA capitalization grants awarded, drawn, and the remaining balance as of June 30, 2010. The year column relates directly to the grant amount column and represents the year the grant funds were appropriated by Congress. The amount drawn column is as of June 30, 2010, and may have been drawn over multiple years.

Federal Fiscal Year Available	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	8,004,100	-
2004	8,303,100	8,303,100	-
2005	8,285,500	8,285,500	-
2006	8,229,300	8,229,300	-
2007	8,229,000	8,139,705	89,295
2008	8,146,000	7,152,588	993,412
2009 ARRA	19,500,000	15,715,842	3,784,158
2009	8,146,000	5,487,728	2,658,272
TOTAL	$ 127,850,726	$ 120,325,589	$ 7,525,137

The 2009 grant was delayed and was not awarded until September 10, 2009, after the end of State fiscal year 2009. Although the 2009 grant was delayed, the grant award allowed the Agency to charge expenditures for projects to the grant effective October 1, 2008.

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

Contributed Capital July 1, 2009	$ 92,515,873
Contributed During the Year:	
Funds From EPA	14,422,710
Funds From ARRA	15,715,842
Administrative Cash Funds Match	1,629,000
Contributed Capital June 30, 2010	$ 124,283,425

Also included in the Contributed Capital is a total of all general funds received by the Program from the Nebraska State Legislature. 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. The State also used $1,629,000 of Administrative Cash Funds to provide the match for the 2009 capitalization grant.

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

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.

7. Interest on Fund Balance – State Operating Investment Pool

The reported amount represents the earnings the Program received from idle funds invested by the Nebraska State Treasurer with the State's Investment Council. 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 § 1452 of the Safe Drinking Water Act. The four set-aside activities are:

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

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

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. Other significant categories of expenses are 30% Loan Forgiveness, and Interest Expense-State Match Bonds.

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

9. Operating Expenses (Continued)

Following is an explanation of these categories:

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 4 percent for administrative costs in one year, it can bank the excess balance and use it for administrative costs in later years. The Department did not expend any of the administration from Federal funds. The Administration costs were paid from loan fee revenues.

15% Source Water Assessment Program

Identified in Federal regulations as local assistance and other state programs, a 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;
- 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.

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.

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

9. Operating Expenses (Concluded)

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 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.

ARRA provided additional funding in the form of principal forgiveness; however, the grant had different forgiveness regulations than regular base Drinking Water loans. ARRA requires the State to use at least 50 percent of the funds provided by this grant to provide additional subsidization in the form of principal forgiveness.

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 Employees Retirement Plan (Plan)

The single-employer plan became effective by statute on January 1, 1964. The Plan consists of a defined contribution option and a cash balance benefit. 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. The benefits and funding policy of the Plan is established and can only be amended by the Nebraska Legislature.

10. State Employees Retirement Plan (Plan) (Concluded)

All permanent full-time employees are required to begin participation in the retirement system upon employment. All permanent part-time employees, who have attained the age of twenty years, may exercise the option to begin participation in the retirement system.

Contribution. Per statute, 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 fully vested after a total of three years of participation in the system, including 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 a 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, 2010, employees contributed $12,451 and the Department contributed $19,423. A separate plan report is issued and can be obtained from the Nebraska Public Employees Retirement System. This report contains full pension-related disclosures.

The State of Nebraska CAFR also includes pension-related disclosures. The CAFR is available from the Nebraska Department of Administrative Services – Accounting Division or on the Nebraska Auditor of Public Accounts website at www.auditors.state.ne.us.

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

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. DAS is responsible for maintaining the insurance and self-insurance programs for the State. The State generally self-insures for general liability, employee health care, employee indemnification, 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 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. Life insurance for eligible employees.

C. Crime coverage, with a limit of $31 million for each loss, and a $25,000 self-insured retention per incident subject to specific conditions, limits, and exclusions.

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 coverage, sub-limits, and self insurance. State agencies have the option to purchase building contents and inland marine coverage.

Details of the various insurance coverages are available from DAS - Risk Management Division.

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 Program's financial statements.

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. Subsequent Event

The State is currently working with NIFA (the relationship as explained in Note 4) to issue Series 2010A Bonds in the amount of $3,110,000 for the purpose of providing the required State match for the 2010 grant. The bond sale was not completed by the end of the fiscal year; however, was tentatively planned to occur on December 2, 2010.

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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, 2010, and have issued our report thereon dated November 10, 2010. The 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 (internal control) 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.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A material weakness is a deficiency or combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above. However, we identified a certain deficiency in internal control that we consider to be a significant deficiency that is described in the Comments Section of the report: Comment Number 1 (Financial Statement Errors). A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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*.

We noted additional items that we reported to management of the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program in the Comments Section of this report as Comment Number 2 (Loan Testing), Comment Number 3 (Reporting), and Comment Number 4 (20% State Match Requirements).

The Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's written response to the findings identified in our audit are described in the Comments Section of the report. We did not examine the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's response and accordingly, we express no opinion on it. Where no response is indicated, the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program declined to respond.

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

Signed Original on File

November 10, 2010

Don Dunlap, CPA
Assistant Deputy Auditor

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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 THE *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, 2010. 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.

As described in Comment Number 4 (20% State Match Requirements) in the Comments Section of this report, the Nebraska Department of Environmental Quality did not comply with the 20% State Match Requirements that are applicable to its Drinking Water State Revolving Fund Program. Compliance with such requirements is necessary, in our opinion, for the Nebraska Department of Environmental Quality to comply with the requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraph, the Nebraska Department of Environmental Quality complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on its Drinking Water State Revolving Fund Program for the year ended June 30, 2010.

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 *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a Federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a Federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, 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. However, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies as described in the Comments Section of this report as Comment Number 2 (Loan Testing), and Comment Number 3 (Reporting). A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a Federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

The Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's written response to the findings identified in our audit are described in the Comments Section of the report. We did not examine the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's response and accordingly, we express no opinion on it. Where no response is indicated, the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program declined to respond.

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

Signed Original on File

November 10, 2010

Don Dunlap CPA
Assistant Deputy Auditor