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

JULY 1, 2011 THROUGH JUNE 30, 2012

Issued on April 8, 2013

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND PROGRAM

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BACKGROUND

The Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program (Program) was established pursuant to Title VI of the Federal Clean Water Act, as amended by the Water Quality Act of 1987. Neb. Rev. Stat. § 81-15,147 created the Wastewater Treatment Facilities Construction Assistance Act. The Federal Water Quality Act and State statutes established the Clean Water State Revolving Fund Program to provide loans, at reduced interest rates, to finance the construction of publicly and privately owned water pollution control facilities, non-point source pollution control projects, and estuary management plans. Instead of making grants to communities that pay for a portion of the building of wastewater treatment 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. The Program was capitalized by the United States Environmental Protection Agency (EPA) by a series of grants starting in 1989. 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, 2012, the EPA had awarded $174 million in Capitalization grants to the State. Of the $174 million awarded, approximately $20 million was funded by the American Recovery and Reinvestment Act (ARRA). The $154 million not funded by ARRA required the State to contribute approximately $31 million in matching funds. The State provided appropriations to contribute $955,000 of the funds to meet the State's matching requirement. Additional matching funds were obtained through the issuance of revenue bonds.

The Program is administered by the Nebraska Department of Environmental Quality (Agency). The Agency's primary activities with regard to the Program include the making of loans for water pollution control facilities and the management and coordination of the Program. The Nebraska Environmental Quality Council approves the rules and regulations of the Agency and the Program's Intended Use Plan.

EXIT CONFERENCE

An exit conference was held February 27, 2013, with the Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program to discuss the results of our examination. Those in attendance for the Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program were:

NAME	TITLE
Tom Lamberson	Deputy Director
Martie Guthrie	Budget Officer III
Mary Brady	Federal Aid Administrator II
Donna Garden	FAS/SRF Section Supervisor
Kris Young	Accountant III
Jim Novotny	Accountant III
Mary Schroer	Program Specialist
Pat Rice	Assistant Director
John Danforth	Env. Assistance Coordinator
Curtis Youngman	State Accounting
Chin Chew	Department of Health and Human Services
Jack Daniel	Department of Health and Human Services
Steve Rowell	Department of Health and Human Services
Marty Link	Associate Director

SUMMARY OF COMMENTS

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

1. ***Loan Testing:*** During State fiscal year 2012, the Agency paid $10,966,409 to 21 subrecipients, of which $2,969,087 was Federal funding. During testing it was noted the Agency had not established any formal financial capability requirements. As a result, for all loans tested, the Agency could not provide documentation of how they determined the subrecipient met the financial capability standards set by statute. In addition, the Agency did not communicate CFDA title and number, award name and number, and the amount of ARRA funds with each disbursement made to the subrecipient.

2. ***Loan Repayments:*** During State fiscal year 2012, the Agency received $29,179,913 from 182 subrecipients. We selected 19 subrecipients' loan repayments totaling $639,221. During testing it was noted one repayment did not have documentation of the project's substantial completion or initiation of operation and four repayments did not commence within one year of the project's substantial completion and initiation of operation dates. It was also noted Federal regulations required repayment commence within one year of substantial completion, which differed from the Agency's regulations which required repayment commence within one year of initiation of operation or three years after the loan agreement date.

3. ***Cash Management:*** For all ten loan payments tested, we could not determine whether the subrecipient paid their contractors in a timely manner, as the Agency did not have supporting documentation on file showing when the subrecipient paid their contractors.

4. ***Federal Reporting:*** During testing of all three Federal Financial Reports (FFR) submitted in the State fiscal year, it was noted two reports were not complete and accurate as program income was not reported, two reports had no documentation the reports were prepared and reviewed by separate individuals, and one report included the incorrect reporting period end date.

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.

COMMENTS AND RECOMMENDATIONS

1. Loan Testing

Program: CFDA 66.458 – Capitalization Grants for Clean Water State Revolving Funds (CWSRF) and ARRA CWSRF – Activities Allowed or Unallowed/Subrecipient Monitoring

Grant Number & Year: All open grants including #CS-31000111-0, FFY 2011; #CS-31000110-0, FFY 2010; #2W-97705101-0, FFY 2009 (ARRA)

Federal Grantor Agency: U.S. Environmental Protection Agency

Criteria: Neb. Rev. Stat. § 81-15,155 (Reissue 2008) states, "All loans made under the Wastewater Treatment Facilities Construction Assistance Act shall be made only to municipalities or to counties that: (a) Meet the requirements of financial capability set by the department."

2 CFR § 176.210(c) (January 1, 2011) 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 CFR § 176.210(d) (January 1, 2011) states,

> *"Recipients agree to require their subrecipients to include on their SEFA [Schedule of Expenditures of Federal Awards] 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."*

Condition: During State fiscal year 2012, the Agency paid $10,966,409 to 21 subrecipients, of which $2,969,087 was Federal funding. We selected five loans to subrecipients who received a total of $2,114,366, of which $1,398,933 was Federal funding, during the State fiscal year. During testing it was noted:

- The Agency had not established any formal financial capability requirements. As a result, for all five loans tested, the Agency could not provide documentation of how they determined the subrecipient met the financial capability standards set by statute.

- The Agency did not communicate CFDA title and number, award name and number, and the amount of ARRA funds with each disbursement made to the subrecipient.

COMMENTS AND RECOMMENDATIONS
(Continued)

1. Loan Testing (Continued)

Questioned Costs: Unknown

Context: During testing it was noted:

- Per discussion with the Financial Assistance Section Supervisor, the financial capability analysis, included as an attachment to the loan contract, was viewed as a summary document of the subrecipient's position. The Agency had not established the requirements needed to be met, but the State Revolving Fund manual did identify information that should be considered when completing the financial capability analysis document.

- The Agency sent an annual letter to each subrecipient that included the Federal dollars paid, CFDA information, and the SEFA identification requirements for ARRA funds.

- A similar comment was noted in the prior audit.

Cause:

- The Agency had no formal requirements established to evaluate the financial, technical, and managerial capability of the subrecipient. Therefore, there was no documentation of the Agency's analysis of the attributes being performed.

- The Agency provided the required information annually, but not with each disbursement.

Effect: There is an increased potential for noncompliance with State statutes and Federal compliance requirements.

Recommendation: We recommend the following:

- The Agency establish standards identifying the minimum requirements needed for a political subdivision to have the financial capability to repay a loan.

- The Agency compare their standards to each subrecipient's financial capability information and document how the standards were met.

- At the time of each disbursement, the Agency notify the subrecipient of the CFDA title and number, award name and number, and the amount of ARRA funds.

> **Management Response:** As of 2/28/2013, the Agency has implemented the corrective actions below to address this Finding.

COMMENTS AND RECOMMENDATIONS
(Continued)

1. Loan Testing (Concluded)

Corrective Action:

- NDEQ will follow Federal Environmental Protection Agency guidelines recommending sewer fees be no more than 2% of Median Household Income (MHI). Any municipality below this is eligible for SRF loans. Any municipality over the 2% of MHI rate will require re-assessment of scope of project and risk to the fund.

- In order to document this standard, the Financial Capabilities analysis will report the percent of MHI.

- Documentation mailed at the time of disbursement notifying the subrecipient of disbursement will include CFDA title and number, and award name and number. The ARRA Grant is completed and closed. Forms have been modified as of 2/28/13.

Contact: Donna Garden, Financial Assistance Section Supervisor

Anticipated Completion Date: Completed

2. Loan Repayments

Program: CFDA 66.458 – Capitalization Grants for Clean Water State Revolving Funds and ARRA CWSRF – Program Income

Grant Number & Year: All open grants including #CS-31000111-0, FFY 2011; #CS-31000110-0, FFY 2010; #2W-97705101-0, FFY 2009 (ARRA)

Federal Grantor Agency: U.S. Environmental Protection Agency

Criteria: 40 CFR § 35.3120(a)(1)(ii) (July 1, 2011) states, "The annual repayment of principal and payment of interest begins not later than one year after project completion."

Neb. Rev. Stat. § 81-15,155 (Reissue 2008) states, "(1) All loans made under the Wastewater Treatment Facilities Construction Assistance Act shall be made only to municipalities or to counties that: …Provide a written notice of completion and start of operation of the facility."

Title 131 Nebraska Administrative Code (NAC) 8-004.03 states, "The annual principal and interest payment due from a loan recipient shall commence no later than one year after Initiation of Operation or no later than three years from the date of the loan contract, whichever occurs first."

COMMENTS AND RECOMMENDATIONS
(Continued)

2. Loan Repayments (Continued)

Condition: During State fiscal year 2012, the Agency received $29,179,913 from 182 subrecipients. We selected 19 subrecipients' loan repayments totaling $639,221. During testing it was noted:

- For 1 of 19 repayments tested, the Agency did not have documentation of the project's substantial completion or initiation of operation.
- For 4 of 19 repayments tested, repayment did not commence within one year of the project's substantial completion and initiation of operation dates. These four repayments were up to 44 days late.
- Federal regulations required repayment commence within one year of substantial completion, which differed from NAC which required repayment commence within one year of initiation of operation or three years after the loan agreement date.

Questioned Costs: None

Context: During testing it was noted:

- Documentation of initiation of operation and/or substantial completion dates were difficult to determine because the Agency used several different documents establishing each date.
- Federal criteria and NAC disagree on whether substantial completion or initiation of operation should be used to determine commencement of repayment.

Cause:

- Subrecipient did not provide the Agency with documentation of substantial completion or initiation of operation in a timely matter.
- Due to conflicting Federal regulations and Agency rules and regulations, it was difficult to determine when repayment should have been commenced.

Effect:

- There is an increased potential for noncompliance with Agency rules and regulations, as well as Federal grant compliance requirements.
- Without documentation to commence loan repayment, the subrecipient could improperly postpone the commencement of repayment.

Recommendation: We recommend the following:

COMMENTS AND RECOMMENDATIONS
(Continued)

2. Loan Repayments (Concluded)

- The Agency establish procedures to ensure the repayment commences according to both substantial completion and initiation of operation. The required loan file documentation should clearly identify the dates of substantial completion and initiation of operation.

- The Agency review their rules and regulations related to commencement of loan repayment to ensure they agree with Federal regulations and State statutes.

Management Response: As of March 7, 2013 the Agency has implemented the following corrective actions.

Corrective Action: The Agency adopted and is using a revised loan contracts check list that includes the requirement for documented Initiation of Operation date. This documentation would be provided by the municipality's engineer or the municipality. This date will be used to determine the first payment date.

The Agency will review and document the differences if any, between State rules/regulations and Federal Regulations. The more stringent of the two will be utilized until Title 131 can be changed (if necessary).

Contact: Donna Garden, Supervisor Financial Assistance Section

Anticipated Completion Date: Checklist modification complete. Review of regulations before June 30, 2013 end. Modification to rule/regulations if necessary, will occur when regulations are reviewed before the Environmental Quality Council.

3. Cash Management

Program: CFDA 66.458 – Capitalization Grants for Clean Water State Revolving Funds (CWSRF) and ARRA CWSRF – Cash Management

Grant Number & Year: All open grants including #CS-31000110-0, FFY 2010; #CS-31000111-0, FFY 2011; #2W-99705101-0, FFY 2009 (ARRA)

Federal Grantor Agency: U.S. Environmental Protection Agency

Criteria: Per 40 CFR § 31.37(a)(4), States shall "Conform any advances of grant funds to subgrantees substantially to the same standards of timing and amount that apply to cash advances by Federal agencies."

Per CWSRF loan documents Section 2.10, Other Conditions and Terms, *(i)* ***Contractor's Payments.*** The Borrower agrees to make prompt payment to its contractor(s) of sums due for construction and to retain only such amounts as may be justified by specific circumstances and provisions of the construction contract.

COMMENTS AND RECOMMENDATIONS
(Continued)

3. Cash Management (Concluded)

Condition: We selected ten total loan payments to five subrecipients who received a total of $2,114,366, of which $1,398,933 was Federal funding. For all ten payments tested, we could not determine whether the subrecipient paid their contractors in a timely manner, as the Agency did not have supporting documentation on file showing when the subrecipient paid their contractors.

Questioned Costs: None

Context: The total payments made to 21 subrecipients in State fiscal year 2012 were $10,966,409, of which $2,969,087 was Federal funding. Many of the subrecipients were small entities who probably did not have the cash flow to pay their contractors before receiving payments from the Agency.

Cause: The Agency had a requirement in the loan agreement that the recipient pay contractors timely, but did not monitor whether this requirement was met.

Effect: The Agency may not be in compliance with Federal regulations and Federal cash payments to subrecipients may have been improperly used.

Recommendation: We recommend the Agency institute procedures to ensure subrecipients are making payments to their contractors in a timely manner.

> **Management Response:** Ensuring payments in a timely manner is dependent on the timing of the municipality's governing body approval process. With small communities this depends on a monthly board meeting. Documentation actions below were implemented by the Agency.
>
> **Corrective Action:** As of March 4, 2013 each disbursement request from loan recipients will include information on the previous disbursement. This information includes date(s) and Check or Transaction number(s). Final Payment will be verified separately.
>
> **Contact:** Donna Garden, Supervisor Financial Assistance Section
>
> **Anticipated Completion Date:** Completed

4. Federal Reporting

Program: CFDA 66.458 – Capitalization Grants for Clean Water State Revolving Funds and ARRA CWSRF – Reporting

Grant Number & Year: #CS-31000106-0, FFY 2006; #2W-97705101-0, FFY 2009 (ARRA)

COMMENTS AND RECOMMENDATIONS
(Continued)

4. Federal Reporting (Continued)

Federal Grantor Agency: U.S. Environmental Protection Agency

Criteria: Per OMB Circular A-133, an Agency has the responsibility to ensure compliance with Federal requirements through the use of sound internal controls. A good internal control plan requires policies and procedures to ensure all the information reported on Federal Financial Report (FFR) forms is complete and accurate. The FFR form requires Federal program income be reported.

Condition: During testing of all three FFRs submitted during the State fiscal year it was noted:

- Two of the three reports were not complete and accurate, as program income was not reported.
- For two of the three reports, there was no documentation the reports were prepared and reviewed by separate individuals.
- One of the three reports included the incorrect reporting period end date.

Questioned Costs: None

Context: During testing it was noted:

- Program income not reported was $48,751.
- The final FFR for the Clean Water ARRA grant submitted May 31, 2012, reported program income and included documentation of both the preparer and approver.
- For the annual ARRA FFR submitted October 3, 2011, the reporting period end date was listed as October 1, 2010, when the correct reporting period end date was September 30, 2011.

A similar finding was noted in the prior audit.

Cause: The Agency was working with the EPA to determine how program income should be reported. The Agency reached an agreement with the EPA in February 2012.

Effect: Noncompliance with Federal regulations, which could result in sanctions.

Recommendation: We recommend the Agency implement procedures to review FFRs before they are submitted to ensure all data included is accurate and complete, including the reporting of program income. In addition, the Agency should continue to document the preparer and approver of all reports.

COMMENTS AND RECOMMENDATIONS
(Continued)

4. **Federal Reporting** (Concluded)

Management Response: This issue was noted during the last fiscal year audit, and action was taken immediately after the previous audit exit conference.

Corrective Action Plan: Federal Financial Reports are compiled by the Accountant III position, and reviewed by the Budget Officer III position prior to submittal. Compilation and review are both documented through signatures, and indications made that supporting documentation has been compared to the final report.

Contact: Martie Guthrie, Budget Officer III

Anticipated Completion Date: Completed

NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN 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 – Clean Water State Revolving Fund Program (Program), as of and for the year ended June 30, 2012, which collectively comprise the Program's basic financial statements 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Program's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements of the Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program are intended to present the financial position, changes in financial position, and cash flows 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 – Clean 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, 2012, and its changes in financial position or cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business type activities of the Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program, as of June 30, 2012, the respective changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 27, 2013, on our consideration of the Nebraska Department of Environmental Quality – Clean 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. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* 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 27, 2013, on our consideration of the Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program's internal control over compliance and our tests of its compliance with certain provisions of laws, regulations, and grants.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 14 through 17 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

SIGNED ORIGINAL ON FILE

March 27, 2013

Don Dunlap, CPA
Assistant Deputy Auditor

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

This section of the Nebraska Department of Environmental Quality (Agency) – Clean 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, 2012. This analysis has been prepared by management of the Agency and is intended to be read in conjunction with the Program's financial statements and related footnotes which 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 additional information that is essential to a full understanding of the data provided in the financial statements.

AMERICAN RECOVERY AND REINVESTMENT FUNDS

Nebraska was awarded $20,045,000 in American Recovery and Reinvestment Act (ARRA) funds for wastewater treatment facility improvements, which are known as Clean Water projects. These funds are administered by the Agency. The purpose of these funds is to improve the wastewater infrastructure in communities that have been identified as having significant needs.

The ARRA funds supplement the State's Clean Water State Revolving Fund (CWSRF). The CWSRF provides low-interest loans to communities for construction of wastewater treatment facilities and sanitary sewer collection systems to alleviate public health and environmental problems. The Agency's CWSRF loan program annually surveys the wastewater needs of communities across the State, and develops an Intended Use Plan that prioritizes those needs and is the basis for allocating the loans.

The $20 million in ARRA funds was blended with approximately $34 million of Nebraska's existing CWSRF loan funds. Prior to the addition of ARRA funds, the 2009 CWSRF Intended Use Plan had targeted six communities to receive low-interest loans in 2009, with numerous other communities waiting for future funding. The addition of the ARRA funds expanded this list to 16 communities that received a combination of low-interest loans and loan forgiveness. These communities were offered a package including a 50 percent low-interest loan from existing State CWSRF funding, a 25 percent no-interest loan of ARRA funds, and 25 percent loan forgiveness of ARRA funds. ARRA requires the State to use at least 50 percent of the ARRA funds supplied by this grant to provide additional subsidization, which the State elected to do in the form of loan forgiveness.

ANALYSIS OF BALANCES AND TRANSACTIONS OF ENTERPRISE FUND

Changes in Net Assets

For the fiscal year ended June 30, 2012, net assets of the Program increased by 3%. Revenues decreased by 59.8% and expenses decreased 61.1%. The increase in current assets was primarily due to several loan payoffs. Operating expenses decreased due to the majority of ARRA forgiveness being given out in previous years, and the completion of the ARRA grant. Revenues decreased significantly as ARRA grant draws declined as that grant was almost completely utilized by the end of fiscal year 2011.

NET ASSETS

	2012	2011	% Change
Current Assets	$ 103,678,002	$ 102,400,109	1%
Noncurrent Assets	129,453,302	124,071,404	4%
Total Assets	233,131,304	226,471,513	3%
Current Liabilities	33,310	35,775	(7%)
Noncurrent Liabilities	104,620	113,063	(7%)
Total Liabilities	137,930	148,838	(7%)
Net Assets:			
Unrestricted	232,993,374	226,322,675	3%
Total Net Assets	$ 232,993,374	$ 226,322,675	3%

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

CHANGES IN NET ASSETS

	2012	2011	%Change
Loan Fee Administration	$ 1,133,028	$ 1,267,361	(11%)
Interest	5,961,621	6,442,076	(7%)
Fines, Forfeits, and Penalties	593	496	20%
Debt Service Refund	833	-	100.0%
Total Operating Revenue	7,096,075	7,709,933	(8%)
Administration	1,510,696	1,635,815	(8%)
ARRA Loan Forgiveness	26,547	4,573,879	(99%)
Non-ARRA Loan Forgiveness	1,328,986	1,178,292	13%
Total Operating Expenses	2,866,229	7,387,986	(61%)
Operating Income	4,229,846	321,947	100%
Capital Contributions Federal Grants	2,402,781	6,605,026	(64%)
Capital Contributions ARRA Grants	53,197	9,422,500	(99%)
Interest Expense on Bonds Payable	(15,125)	(12,001)	26%
Net Nonoperating Revenue (Expenses)	2,440,853	16,015,525	(85%)
Change in Net Assets	6,670,699	16,337,472	(59%)
Beginning Net Assets July 1	226,322,675	209,985,203	8%
Ending Net Assets June 30	$ 232,993,374	$ 226,322,675	3%

ECONOMIC OUTLOOK

Nebraska's economy has been affected by the current national economic decline in recent years; however, net State general fund revenues for fiscal year 2012 finished the year 2.9% above projections. The State has continued to take steps to avert major economic impacts both statewide and within communities. The small rural makeup of the State remains to be a challenge for communities in funding major capital projects. Declining population bases make it difficult to draw the amount of user fees needed to fund infrastructure requirements. As of the fiscal year ended June 30, 2012, the Program had received $20,045,000 in ARRA funds and about half of those funds were provided as loan forgiveness to communities. The ARRA funding does not require a State match.

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

DEBT ADMINISTRATION

Short–Term Debt

The Clean Water State Revolving Fund Program had debt activity during the fiscal year that was short-term in nature resulting from a bond issue. The issue was for $1,505,000, which was repaid within the same fiscal year.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND PROGRAM
BALANCE SHEET
JUNE 30, 2012

		Enterprise Fund
ASSETS		
CURRENT ASSETS:		
Cash in State Treasury (Note 2)	$	84,058,410
Administration Fees Receivable		464
Loan Interest Receivable		1,393
Interest Receivable		165,751
Loans Receivable (Note 3)		19,451,984
TOTAL CURRENT ASSETS		103,678,002
NON-CURRENT ASSETS		
Loans Receivable (Note 3)		129,453,302
TOTAL NON-CURRENT ASSETS		129,453,302
TOTAL ASSETS	$	233,131,304
LIABILITIES		
CURRENT LIABILITIES		
Accounts Payable & Accrued Liabilities	$	25,436
Compensated Absences (Note 5)		7,874
TOTAL CURRENT LIABILITIES		33,310
NON-CURRENT LIABILITIES		
Compensated Absences (Note 5)		104,620
TOTAL NON-CURRENT LIABILITIES		104,620
TOTAL LIABILITIES		137,930
NET ASSETS		
Unrestricted		232,993,374
TOTAL NET ASSETS		232,993,374
TOTAL LIABILITIES AND NET ASSETS	$	233,131,304

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

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND PROGRAM
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
For the Year Ended June 30, 2012

		Enterprise Fund
OPERATING REVENUES:		
Loan Fees Administration (Note 7)	$	1,133,028
Interest on Loans		3,951,987
Interest on Fund Balance - State Operating Investment Pool (Note 8)		2,009,634
Fines, Forfeits, and Penalties		593
Debt Service Refund		833
TOTAL OPERATING REVENUES		7,096,075
OPERATING EXPENSES:		
Administrative Costs From Fees		731,849
4% Administrative Costs From Grants		136,064
Small Town Grants (Note 9)		642,423
Facility Planning Grants		360
Loan Forgiveness ARRA (Note 9)		26,547
Loan Forgiveness Non-ARRA		1,328,986
TOTAL OPERATING EXPENSES		2,866,229
OPERATING INCOME		4,229,846
NONOPERATING REVENUE (EXPENSE)		
Capital Contributions - Federal Grants		2,402,781
Capital Contributions - ARRA Federal Grants		53,197
Interest Expense on Bonds Payable (Note 12)		(15,125)
NET NONOPERATING REVENUE (EXPENSE)		2,440,853
CHANGE IN NET ASSETS		6,670,699
TOTAL NET ASSETS, BEGINNING OF YEAR		226,322,675
TOTAL NET ASSETS, END OF YEAR	$	232,993,374

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

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND PROGRAM
STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2012

	Enterprise Fund
CASH FLOWS FROM OPERATING ACTIVITIES:	
Receipts From Customers	$ 30,417,283
Interest on Investments	2,001,686
Payments for Administration	(878,820)
Payments for Small Town Grants	(642,423)
Payments for Facility Planning Grants	(360)
Loan Forgiveness	(1,355,533)
Payments to Borrowers	(24,837,668)
Debt Service Refund	833
NET CASH PROVIDED BY OPERATING ACTIVITIES	4,704,998
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:	
Funds Received From the Environmental Protection Agency	2,402,781
Funds Received From the Environmental Protection Agency-ARRA Funds	53,197
Receipts From Bond Issue	1,505,000
Repayment of Bond	(1,505,000)
Interest on Bond	(15,125)
NET CASH FROM NON-CAPITAL FINANCING ACTIVITIES	2,440,853
Increase in Cash and Cash Equivalent	7,145,851
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	76,912,559
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 84,058,410
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:	
Operating Income	$ 4,229,846
ADJUSTMENTS TO RECONCILE OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:	
Decrease in Loans Receivable	494,696
Decrease in Interest Receivable	(7,947)
Decrease in Administration Fees Receivable	(172)
Decrease in Loan Interest Receivable	(516)
Increase in Compensated Absences	(9,079)
Increase in Accounts Payable & Accrued Liabilities	(1,830)
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 4,704,998

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

NOTES TO THE FINANCIAL STATEMENTS

For the Fiscal Year Ended June 30, 2012

1. Summary of Significant Accounting Policies

A. Basis of Presentation

The accompanying basic financial statements of the Nebraska Department of Environmental Quality (Agency) – Clean 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).

B. Reporting Entity

The Clean Water State Revolving Fund Program is a program within the Agency and is established under and governed by the Clean Water Act of the Federal Government and by laws of the State of Nebraska. The Agency is a State agency established under and governed by the laws of the State of Nebraska. As such, the Agency is exempt from State and Federal income taxes. The Program's management has also considered all potential component units of the Program for which it is financially accountable, and other organizations which are fiscally dependent on the Program's management, or the significance of their relationship with the Program's management 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 Agency 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 Agency.

As required by generally accepted accounting principles, these financial statements present the Nebraska Department of Environmental Quality – Clean 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 purpose of carrying on activities or attaining objectives in accordance with specific

1. Summary of Significant Accounting Policies (Continued)

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. It includes the following funds as identified in the Wastewater Treatment Facilities Construction Assistance Act:

- Clean Water Facilities Funds – General Fund 10000, Federal Funds 48412 and 48413, and Bond Funds 68470, 68471, 68472, and 68473.

- Administration Funds – Cash Funds 28460, 28461, and 28462.

In addition to the funds above, the Agency created Fund 48410 to track ARRA activity.

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 Agency have decided that the determination of the 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 they meet the definition of special revenue funds as defined by GASB Statement 54. In that statement special revenue funds are defined as funds used to account for and report the proceeds of specific revenue sources that are restricted or committed to expenditure for specific purposes.

D. Measurement Focus, Basis of Accounting

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus and basis of accounting. 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.

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.

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

1. Summary of Significant Accounting Policies (Continued)

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, 2012, 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.

F. Loans Receivable

The State operates the Program as a direct loan program, whereby loans are made to communities. The entire Clean Water Program is funded, on average, 83.33% from Federal capitalization grants and 16.67% from State matching funds, other than 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 1.25% to 5.25% and the terms are between 5 to 20 years. The current and non-current loans receivable amounts were determined using the amount of principal payment due to the Program at June 30, 2012, and classified based on known and anticipated collections during fiscal year 2013.

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 is a provision for the Program to intercept State aid to a community in default of its loan.

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

1. Summary of Significant Accounting Policies (Concluded)

G. 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.

H. Compensated Absences

All permanent employees working for the Program earn sick and annual leave and are allowed to accumulate compensatory leave rather than being paid overtime. Temporary and intermittent employees are not eligible for paid leave. The liability has been calculated using the vesting method, in which leave amounts, for both employees who are currently eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination, are included.

Program employees accrue vested annual leave at a variable rate based on years of service. Generally, accrued annual leave cannot exceed 35 days at the end of a calendar year. Employees accrue sick leave at a variable rate based on years of service. In general, accrued sick leave cannot exceed 180 days. There is no maximum limit on the accumulation of sick leave days for employees under certain labor contracts. Sick leave is not vested except upon death or upon reaching the retirement eligibility age of 55, or at a younger age if the employee meets all criteria necessary to retire under the primary retirement plan covering his/her State employment, at which time the State is liable for 25 percent of the employee’s accumulated sick leave. Employees under certain labor contracts can only be paid a maximum of 60 days.

The Program financial statements recognize the expense and accrued liability when vacation and compensatory leave is earned or when sick leave is expected to be paid as termination payments.

I. 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 primary operating revenues of the Program are the Loan Fees Administration and interest from loans, since making loans is the primary purpose of the Program. The principal operating expenses of the Program are administration expenses and loan forgiveness.

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

2. Cash in State Treasury

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, 2012. All interest revenue is allocated to the general fund except allocations required by law to be made to other funds. All funds of the Clean Water State Revolving Fund Program were designated for investment during fiscal year 2012. Amounts are allocated on a monthly basis based on average balances of all invested funds.

3. Loans Receivable

As of June 30, 2012, the Program had 167 outstanding loans with communities that totaled $148,905,286. The outstanding balances of the ten communities with the largest loan balances, which represent 53.8% of the total loans, were as follows:

Community	Outstanding Balance
Omaha	$ 13,673,941
North Platte	12,131,886
Lincoln	11,922,958
Gosper County SID #1	9,746,060
Lower Platte North NRD	9,303,660
Broken Bow	5,318,801
Scottsbluff	4,719,160
Wayne	4,567,175
South Sioux City	4,383,926
Sidney	4,282,254
TOTAL	**$ 80,049,821**

4. Bonds Payable

The EPA requires the Program to provide 20% matching funds for each capitalization grant under Sec. 602(b)(2) of the Federal Clean Water Act. During the fiscal year, the Program issued Series 2011B short-term revenue bonds to meet this requirement. Bond Series 2011B was retired during the year ended June 30, 2012. Bonds Payable activity for fiscal year 2012 was:

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

4. Bonds Payable (Concluded)

	Beginning Balance	Additions	Retirement	Ending Balance
Bonds Payable	$ -	$ 1,505,000	$ 1,505,000	$ -

5. Noncurrent Liabilities

Changes in noncurrent liabilities for the year ended June 30, 2012, were as follows:

	Beginning Balance	Increases	Decreases	Ending Balance	Amounts Due Within One Year
Compensated Absences	$ 121,573	$ -	$ 9,079	$ 112,494	$ 7,874

6. 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 capitalization grants awarded, drawn, and the remaining balance as of June 30, 2012. The year column relates directly to the grant amount column and represents the fiscal year the grant funds were appropriated by Congress. The amount drawn column is as of June 30, 2012, and may have been drawn over multiple years.

Federal Fiscal Year Available	Grant Amount	Amount Drawn	Balance
1989	$ 4,773,100	$ 4,773,100	$ -
1990	4,964,560	4,964,560	-
1991	10,821,580	10,821,580	-
1992	9,938,500	9,938,500	-
1993	9,830,300	9,830,300	-
1994	6,061,600	6,061,600	-
1995	6,263,600	6,263,600	-
1996	10,319,661	10,319,661	-
1997	3,119,900	3,119,900	-

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

6. Net Assets (Concluded)

Federal Fiscal Year Available	Grant Amount	Amount Drawn	Balance
1998	7,019,996	7,019,996	-
1999	6,857,600	6,857,600	-
2000	6,834,000	6,834,000	-
2001	6,797,400	6,797,400	-
2002	6,855,000	6,855,000	-
2003	7,069,900	7,069,900	-
2004	6,747,100	6,747,100	-
2005	5,467,300	5,467,300	-
2006	4,424,300	4,424,300	-
2007	5,429,600	5,429,600	-
2008	3,415,700	3,415,700	-
2009 - ARRA	20,045,000	20,045,000	-
2009	3,415,700	3,415,700	-
2010	10,422,000	8,518,372	1,903,628
2011	7,529,000	466,425	7,062,575
TOTAL	$ 174,422,397	$ 165,456,194	$ 8,966,203

The 2011 grant was delayed and was not awarded until August 31, 2011, after the end of State fiscal year 2011.

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

Contributed Capital July 1, 2011	$ 163,955,217
Contributed During the Year – Funds From EPA	2,402,781
Contributed During the Year – Funds from ARRA	53,197
Contributed Capital June 30, 2012	$ 166,411,195

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 $300,000 and $655,000 in the fiscal years ended June 30, 1989, and 1990, respectively.

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

7. Loan Fees Administration

The reported amount comes from a one percent fee charged to loan recipients each year based on the amount of the loan outstanding. The fee is collected semi-annually and waived for the first year of the loan.

8. Interest on Fund Balance – State Operating 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.

9. Small Town Grants and ARRA Loan Forgiveness

Small Town Grants are made available to communities that have a population of 10,000 people or less. The total maximum of Small Town Grants for State fiscal year 2012 was $850,000. In the 2012 Intended Use Plan, the Agency limited the maximum amount of small town grants to $250,000 per project, concurrent with a Program loan. The maximum amount to be used for Small Town Grants and Planning Grants is set at 65% of the previous State fiscal year's administration fees. The IUP caps this at $850,000. For State fiscal year 2013 the maximum available is $850,000. Projects are prioritized based on type of project and financial hardship. Small Town Grants are funded with loan fees administration funds.

ARRA provided funding in the form of loan forgiveness for Clean Water loans. ARRA requires states to use at least 50% of the funds supplied by this grant to provide additional subsidization in the form of loan forgiveness.

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 or 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.

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.

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

Contribution. Per statute, each member contributes 4.8% of his or her monthly compensation. The Agency 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, 2012, employees contributed $22,758 and the Agency contributed $35,503. 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 Comprehensive Annual Report (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.nebraska.gov.

11. Contingencies and Commitments

Risk Management. The Agency 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 Agency, 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:

11. Contingencies and Commitments (Concluded)

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.

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

12. Reclassification

For the fiscal year ended June 30, 2012, bond interest expense on the Statement of Revenues, Expenses, and Changes in Net Assets was reclassified from an operating expense to a non-operating expense. On the Statement of Cash Flows, bond interest and bond principal payments were reclassified from Cash Flow From Operating Activities to Cash Flow From Non-Capital Financing Activities.

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NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN 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 – Clean Water State Revolving Fund Program as of and for the year ended June 30, 2012, and have issued our report thereon dated March 27, 2013. The report was modified to emphasize the financial statements present only the funds of the Nebraska Department of Environmental Quality – Clean 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
Management of the Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Nebraska Department of Environmental Quality – Clean 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 – Clean 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 – Clean Water State Revolving Fund Program's internal control over financial reporting.

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

Our consideration of internal control over financial reporting 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.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Nebraska Department of Environmental Quality – Clean 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 certain matters that we reported to management of the Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program in the Comments Section of this report as Comment Number 1 (Loan Testing), Comment Number 2 (Loan Repayments), Comment Number 3 (Cash Management), and Comment Number 4 (Federal Reporting).

The Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program's written responses 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 – Clean Water State Revolving Fund Program's response and accordingly, we express no opinion on them.

This report is intended solely for the information and use of management, others within the Nebraska Department of Environmental Quality – Clean 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

March 27, 2013

Don Dunlap, CPA
Assistant Deputy Auditor

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NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND PROGRAM
REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE WITH REQUIREMENTS APPLICABLE TO THE NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY – CLEAN 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

Compliance
We have audited the compliance of the Nebraska Department of Environmental Quality – Clean 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, 2012. We audited the Nebraska Department of Environmental Quality – Clean 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 – Clean Water State Revolving Fund Program's management. Our responsibility is to express an opinion on the Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program's compliance based on our audit.

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 – Clean 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 – Clean Water State Revolving Fund Program's compliance with those requirements.

In our opinion, the Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on the Program for the fiscal year ended June 30, 2012. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with the *U.S. Environmental Protection Agency Audit Guide for Clean Water and Drinking Water State Revolving Fund Programs* and which are described in the Comments Section of this report as Comment Number 1 (Loan Testing), Comment Number 2 (Loan Repayments), Comment Number 3 (Cash Management), and Comment Number 4 (Federal Reporting).

Internal Control Over Compliance

Management of the Nebraska Department of Environmental Quality – Clean 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 applicable to Federal programs. In planning and performing our audit, we considered the Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program's internal control over compliance with requirements that could have a direct and material effect on the Program to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with the *U.S. Environmental Protection Agency Audit Guide for Clean Water and Drinking Water State Revolving Fund Programs*, 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 Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program'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.

The Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program's response to the findings identified in our audit are described in the Comments Section of the report. We did not audit the Nebraska Department of Environmental Quality – Clean Water State Revolving Fund Program's response and accordingly, we express no opinion on the response.

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

March 27, 2013

Don Dunlap CPA
Assistant Deputy Auditor