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

JULY 1, 2011 THROUGH JUNE 30, 2012

Issued on April 8, 2013

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

TABLE OF CONTENTS

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

BACKGROUND

The Nebraska Department of Environmental Quality (Agency) – 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, 2012, the EPA had awarded $131 million in capitalization grants to the State, plus $19.5 million in American Recovery and Reinvestment Act (ARRA) funds. The award of this $131 million required the State to contribute approximately $26 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, $1,965,000 in October 2008, and $3,110,000 in November 2010. The 2009 Capitalization grant was matched with $1,629,000 of Administrative Cash Funds. On July 1, 2011, the Agency retired the 2001, 2002, 2003, 2005 and 2006 bond issues. After the retirement of outstanding debt on these bonds, $872,310 remained from the associated reserve funds of the debt. This was used, along with $1,011,290 of Administrative Cash Funds to match the 2011 Capitalization grant for a total of $1,883,600 ($9,418,000 x 20%).

The Program is administered by the Nebraska Department of Environmental Quality (Agency) and the Nebraska Department of Health and Human Services – Division of Public Health. The Agency'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 Agency 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 February 27, 2013, 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
Mary Brady	Federal Aid Administrator II
Donna Garden	FAS/SRF Section Supervisor
Kris Young	Accountant III
Jim Novotny	Accountant III
John Danforth	Env. Assistance Coordinator
Mary Schroer	Program Specialist
Pat Rice	Assistant Director
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) – 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. ***Aid Testing:*** During State fiscal year 2012, the Agency paid $11,378,984 to 41 subrecipients, of which $8,741,674 was Federal funding. During loan and grant payment testing, it was noted the Agency had not established any formal financial, technical, and managerial capability requirements. As a result, for all five loans tested, we could not determine the subrecipient met the financial, technical, and managerial capability standards set by statute. It was also noted, for one grant payment, the grantee received excess funding because the Agency did not retain the required minimum retention amount, for one grant payment there was no documentation of the program administrator's review and approval, five projects did not have documentation that an on-site review had been performed, and the Agency did not send the CFDA title and number, the award name and number, and the amount of ARRA funds with each disbursement made to the subrecipient.

2. ***Contractual Expenditures:*** For one of three Federal contractual expenditures tested, the expenditure was for budgeted costs and not for actual services provided and for one contractual expenditure tested that reimbursed the Nebraska Department of Health and Human Services (DHHS) for their DWSRF administration costs had limited supporting documentation on file and the reimbursement form was not signed by DHHS' administration.

3. ***Cash Management:*** During testing we selected 21 loan payments to seven subrecipients who received a total of $1,358,028, of which $687,600 was Federal funding. For all 21 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 the two FFRs submitted during the State fiscal period, it was noted both were not complete and accurate as program income was not reported and there was no documentation the reports were prepared and reviewed by separate individuals.

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. Aid Testing

Program: CFDA 66.468 – Capitalization Grants for Drinking Water State Revolving Funds (DWSRF) and ARRA DWSRF – Activities Allowed or Unallowed/ Subrecipient Monitoring

Grant Number & Year: All open grants including #FS-99780510-0, FFY 2010; #FS-99780509-0, FFY 2009; #2F-99705601-0, FFY 2009 (ARRA)

Federal Grantor Agency: U.S. Environmental Protection Agency

Criteria: Neb. Rev. Stat. § 71-5324 (Reissue 2009) states, "All loans made under the Drinking Water State Revolving Fund Act shall be made only to owners of public water systems that: Meet the requirements of financial, technical, and managerial capability set by the department."

OMB Circular A-133 § 400(d)(3) requires that pass-through entities "monitor the activities of subrecipients as necessary to ensure that Federal awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved."

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 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 that ensure expenditures are reviewed and approved prior to payment by a second individual to ensure the payments are made in accordance with loan agreements and adequate documentation is on file documenting all compliance requirements have been met.

COMMENTS AND RECOMMENDATIONS
(Continued)

1. Aid Testing (Continued)

Condition: During State fiscal year 2012, the Agency paid $11,378,984 to 41 subrecipients, of which $8,741,674 was Federal funding. We selected seven subrecipients and 21 loan/grant payments totaling $1,358,028, of which $687,600 was Federal funding, for testing. During testing it was noted:

- The Agency had not established any formal financial capability requirements. As a result, for five loans tested, we could not determine the political subdivision met the financial, technical, and managerial capability standards set by statue.
- For one grant payment, the grantee received excess funding because the Agency did not retain the required minimum retention amount.
- For one grant payment, there was no documentation of the program administrator's review and approval.
- Five projects did not have documentation an on-site review had been performed.
- The Agency did not communicate the CFDA title and number, the award name and number, and the amount of ARRA funds with each disbursement made to the subrecipient.

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 identified information that should have been considered when the financial capability analysis document was completed.
- The grant agreement required 10%, but not less than $2,000, be retained pending final approval of the project. After the grant payment, the Agency retained $562 less than $2,000.
- There was no documentation of the program administrator's approval on a $9,321 grantee payment.
- 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 finding was noted in the prior audit.

COMMENTS AND RECOMMENDATIONS
(Continued)

1. <u>Aid Testing</u> (Continued)

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 minimum retention requirement in a grant agreement was overlooked.

- Source Water Protection grants were still in the early stages of procedure development, so no review by the program administrator had been implemented.

- The reason that no documentation of an onsite review could be found is unknown.

- 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 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.

- The Agency review their procedures and controls to ensure that all Source Water Protection payments are properly reviewed and approved and made in accordance with the grant agreement.

- The Agency ensure on-site reviews are performed and documented.

- At the time of each disbursement, the Agency notify the subrecipient of the CFDA title and number, the 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. **Aid Testing** (Concluded)

Corrective Action:

- NDEQ will follow Federal Environmental Protection Agency guidelines recommending Water System fees be no more than 2.5% of Median Household Income. Any municipality below this is eligible for SRF loans. Any municipality over the 2.5% 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.

- Source Water Protection Payments will be signed by the reviewer and will also be approved by the appropriate Section Supervisor or Division Director.

- Source Water Protection Payments will be 90% of each invoice, eliminating overpayment and one additional site visit or other means of verification will be done and documented.

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

Contact: Donna Garden, Supervisor Financial Assistance Section

Anticipated Completion Date: Completed

2. **Contractual Expenditures**

Program: CFDA 66.468 – Capitalization Grants for Drinking Water State Revolving Funds (DWSRF) and ARRA DWSRF – Allowable Costs/Cost Principles

Grant Number & Year: All open grants including #FS-99780510-0, FFY 2010; #FS-99780509-0, FFY 2009; #2F-99705601-0, FFY 2009 (ARRA)

Federal Grantor Agency: U.S. Environmental Protection Agency

Criteria: OMB Circular A-87 requires that costs charged to Federal programs be adequately documented and conform to the limitations set forth in A-87.

2. <u>Contractual Expenditures</u> (Continued)

Sound business practices and internal controls over Federal expenditures require all payments be made for actual costs of services performed. Sound internal controls also require expenditures be reviewed and approved to ensure supporting documentation is on file and all applicable Federal regulations have been met.

Condition:

- For one of three Federal contractual expenditures tested, the expenditure was for budgeted costs and not for actual services provided.

- For one Federal contractual expenditure tested, the Agency reimbursed the Nebraska Department of Health and Human Services (DHHS) for their DWSRF administration costs, but had limited support documentation on file and the reimbursement form was not signed by DHHS' administration.

Questioned Costs: $18,000 known

Context:

- A contractor was paid $18,000 based on a budget payment schedule. No support for the amount of work actually completed on the project was on file.

- The Agency reimbursed DHHS $1,843,502 based on DHHS' invoices and DHHS' general ledger detail reports from the State's accounting system. The general ledger reports included only the name and amount of vendors paid and the total amount of payroll costs charged to the program. The general ledger reports did not include the names of the DHHS employees charged to the program. The Agency did not perform any procedures to ensure items in the reimbursement adhered to OMB Circular A-87.

- The Agency had established procedures requiring DHHS' administration sign and approve the invoice.

Cause: The Agency believed their documentation was adequate since DHHS should have had controls in place to review all their expenditures to ensure the expenses were in compliance with OMB Circular A-87.

Effect: When expenditures are made based on budgeted rather than actual costs or without adequate supporting documentation, there is an increased risk Federal funds may be used for unallowable activities.

COMMENTS AND RECOMMENDATIONS
(Continued)

2. <u>Contractual Expenditures</u> (Concluded)

Recommendation: We recommend the Agency review their procedures to ensure all contractual expenditures are based on actual work completed and adequate supporting documentation is on file.

> **Management Response:** As DHHS follows NE Department of Administrative Services accounting policies in regards to expenditures, and documents a pre-audit function on those presented to NDEQ for payment, the Agency has placed a strong reliance on those internal controls.
>
> **Corrective Action Plan:** The Agency will coordinate with DHHS management staff in regards to completing a review of grant expenditure reimbursements. A random sample of DHHS billings to the DWSRF grant will be selected throughout the fiscal year. Items to be verified may include allowable activities, eligible staff performing those activities, and pass through grant payments.
>
> **Contact:** Martie Guthrie, Budget Officer III
>
> **Anticipated Completion Date:** June 30, 2013

3. <u>Cash Management</u>

Program: CFDA 66.468 – Capitalization Grants for Drinking Water State Revolving Funds (DWSRF) and ARRA DWSRF – Cash Management

Grant Number & Year: All open grants including #FS-99780510-0, FFY 2010; #FS-99780509-0, FFY 2009; #2F-99705601-0, FFY 2009 (ARRA)

Federal Grantor Agency: U.S. Environmental Protection Agency

Criteria: 40 CFR § 31.37(a)(4) says, 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 the DWSRF loan document 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: During testing we selected 21 loan payments to seven subrecipients who received a total of $1,358,028, of which $687,600 was Federal funding. For all 21 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 subrecipients in State fiscal year 2012 were $11,378,984 to 41 subrecipients, of which $8,741,674 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 would 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 66.468 – Capitalization Grants for Drinking Water State Revolving Funds (DWSRF) and ARRA DWSRF – Reporting

Grant Number & Year: #FS-99780506-0, FFY 2006; #2F-97705601-0, 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 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 the two FFRs submitted during the State fiscal year it was noted:

- Both reports were not complete and accurate, as program income was not reported.
- There was no documentation the reports were prepared and reviewed by separate individuals.

Questioned Costs: None

Context: During testing it was noted:

- Program income not reported was $56,532.
- For both reports submitted during the fiscal year, there was no documentation of separate preparer and approver.

The final FFR for the Drinking Water ARRA grant that was submitted after June 30, 2012, appeared to have reported program income and included documentation that the preparer and approver of the document were different.

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.

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

COMMENTS AND RECOMMENDATIONS
(Continued)

4. Federal Reporting (Concluded)

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

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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, 2012, 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 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 – 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, 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 – Drinking 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 – 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. 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 – Drinking 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 15 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) – 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, 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 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, 2012, net assets of the Program increased by 7%. Operating Revenues for the Program decreased 2% while expenses increased by 18%.

NET ASSETS

	2012	2011	% Change
Current Assets	$ 57,279,155	$ 45,946,245	25%
Noncurrent Assets	80,697,424	90,519,720	(11%)
Total Assets	137,976,579	136,465,965	1%
Current Liabilities	1,486,185	1,940,733	(23%)
Noncurrent Liabilities	8,676,638	14,875,703	(42%)
Total Liabilities	10,162,823	16,816,436	(40%)
Net Assets:			
Restricted	1,693,008	2,273,757	(26%)
Unrestricted	126,120,748	117,375,772	7%
Total Net Assets	$ 127,813,756	$ 119,649,529	7%

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

CHANGES IN NET ASSETS

	2012	2011	% Change
Loan Fees Administration	$ 984,120	$ 913,202	8%
Loan Interest	3,775,439	3,928,206	(4)%
Fines, Forfeits, and Penalties	2,131	199	100%
Total Operating Revenues	4,761,690	4,841,607	(2)%
Administration	2,442,052	1,942,189	26%
ARRA Loan Forgiveness	101,981	1,495,884	(93%)
Non ARRA Loan Forgiveness	2,244,726	631,428	100%
Total Operating Expenses	4,788,759	4,069,501	18%
Operating Income	(27,069)	772,106	(100)%
Nonoperating Revenues (Expenses)			
Capital Federal Grants	8,320,272	4,387,064	90%
Capital Contributions ARRA Grants	278,050	3,275,783	(92%)
Interest Expenses	(407,026)	(660,152)	38%
Bond Expenses	-	(97,084)	100%
Net Nonoperating Revenues (Expenses)	8,191,296	6,905,611	19%
Change in Net Assets	8,164,227	7,677,717	6%
Beginning Net Assets July 1, 2011	119,649,529	113,960,966	5%
Prior Period Adjustment	-	(1,989,154)	(100%)
Total Net Assets, Beginning of Year	119,649,529	111,971,812	7%
Ending Net Assets June 30, 2012	$ 127,813,756	$ 119,649,529	7%

The most significant change from the fiscal year ended June 30, 2011, to the fiscal year ended June 30, 2012, were the Loan Fees Administration and Administration balances, Change in Net Assets and the amount received from Capital Contributions. Past funding received through the American Recovery and Reinvestment Act (ARRA) was disbursed through numerous community loans. As expected, those disbursements dropped off this past fiscal year as the ARRA program neared completion. However, the infusion of ARRA funding has continued to increase the collection of loan fees. Administrative expenses increased from last fiscal year, due to the fact the Program filled empty vacancies and were more fully staffed. Noncurrent Liabilities decreased significantly due to the redemption of five bond series during the fiscal year. This brought the Net Asset total up since there was less debt to pay.

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 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 the fiscal year ended June 30, 2012, the Program had received $19,057,539 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.

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 $26 million in existing funds from the Drinking Water State Revolving Fund. Funding is administered by the Department of Health and Human Services (DHHS) Division of Public Health to provide financial assistance to communities.

The average ARRA base blended loans are 25 percent loan forgiveness. The remaining 75 percent is issued to communities as low-interest loans at 2 percent. ARRA requires the State to use at least 50 percent of the funds awarded by this grant to provide additional subsidization in the form of loan 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, 2012

		Enterprise Fund
ASSETS		
CURRENT ASSETS		
Cash and Cash Equivalents:		
Cash in State Treasury (Note 2)	$	30,927,774
Amounts Held by Trustee (Note 2)		10,703,383
Interest Receivable		61,339
Loans Receivable (Note 3)		15,586,659
TOTAL CURRENT ASSETS		57,279,155
NON-CURRENT ASSETS		
Loans Receivable (Note 3)		80,697,424
TOTAL NON-CURRENT ASSETS		80,697,424
TOTAL ASSETS	$	137,976,579
LIABILITIES		
CURRENT LIABILITIES		
Accounts Payable & Accrued Liabilities	$	313,487
Compensated Absences (Note 5)		1,252
Accrued Bond Interest Payable		201,446
Bonds Payable (Note 4)		970,000
TOTAL CURRENT LIABILITIES		1,486,185
NON-CURRENT LIABILITIES		
Compensated Absences (Note 5)		16,638
Bonds Payable (Note 4)		8,660,000
TOTAL NON-CURRENT LIABILITIES		8,676,638
TOTAL LIABILITIES		10,162,823
NET ASSETS		
Restricted for Bond Payments		1,693,008
Unrestricted		126,120,748
TOTAL NET ASSETS		127,813,756
TOTAL LIABILITIES AND NET ASSETS	$	137,976,579

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, 2012

		Enterprise Fund
OPERATING REVENUES:		
Loan Fees Administration (Note 7)	$	984,120
Interest on Loans		2,663,479
Interest on Fund Balance - Trustee		447,657
Interest on Fund Balance - State Operating Investment Pool (Note 8)		664,303
Fines, Forfeits, and Penalties		2,131
TOTAL OPERATING REVENUES		4,761,690
OPERATING EXPENSES:		
Administration From Fees (Note 9)		383,875
4% Administrative Costs from Grant		-
15% Source Water Assessment Program (Note 9)		505,039
2% Technical Assistance to Small Systems (Note 9)		229,468
10% Public Water Supply System (Note 9)		1,323,670
30% Loan Forgiveness (Note 9)		2,244,726
50% Loan Forgiveness ARRA (Note 9)		101,981
TOTAL OPERATING EXPENSES		4,788,759
OPERATING LOSS		(27,069)
NONOPERATING REVENUE (EXPENSE)		
Capital Contributions - Federal Grants		8,320,272
Capital Contributions - ARRA Federal Grants		278,050
Interest Expense - State Match Bonds (Note 13)		(407,026)
NET NONOPERATING REVENUE (EXPENSE)		8,191,296
CHANGE IN NET ASSETS		8,164,227
TOTAL NET ASSETS, BEGINNING OF YEAR		119,649,529
TOTAL NET ASSETS, END OF YEAR	$	127,813,756

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, 2012

		Enterprise Fund
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts From Customers	$	14,074,648
Interest on Investments		1,101,587
Payments to Borrowers		(10,397,110)
Payments to Borrowers ARRA		(188,272)
Payments for Administration		(399,797)
15% Source Water Assessment Program		(464,122)
2% Technical Assistance to Small Systems		(219,800)
10% Public Water Supply System		(1,276,424)
Loan Forgiveness		(2,244,726)
Loan Forgiveness ARRA		(101,981)
NET CASH PROVIDED BY OPERATING ACTIVITIES		(115,997)
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES		
Funds Received From the Environmental Protection Agency		8,320,272
ARRA Funds Received From the Environmental Protection Agency		278,050
Bond Principal Payments		(6,590,000)
Bond Interest Payments		(555,221)
NET CASH FROM NON-CAPITAL FINANCING ACTIVITIES		1,453,101
Increase in Cash and Cash Equivalents		1,337,104
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR		40,294,053
CASH AND CASH EQUIVALENTS, END OF YEAR	$	41,631,157
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating Loss	$	(27,069)
ADJUSTMENTS TO RECONCILE OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
(Increase)/Decrease in Loans Receivable		(172,439)
(Increase)/Decrease in Interest Receivable		(10,389)
(Increase)/Decrease in Loan Interest Receivable		5,895
(Increase)/Decrease in Admin Fees Receivable		3,423
Increase/(Decrease) in Accounts Payable & Accrued Liabilities		83,577
Increase/(Decrease) in Compensated Absences		1,005
NET CASH PROVIDED BY OPERATING ACTIVITIES	$	(115,997)

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) – 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) for the State match bond accounts.

B. Reporting Entity

The Drinking Water State Revolving Fund Program is a program within the Agency 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 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 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 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 – 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

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

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, 68484, 68485, and 68486.

- Drinking Water Administration Fund – Cash Fund 28630.

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 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 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. 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.

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

1. Summary of Significant Accounting Policies (Continued)

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

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

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 (Continued)

between 5 to 20 years. Disadvantaged communities may have up to 30 years to repay. 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.

G. Restricted Net Assets

When both restricted and unrestricted resources are available for use, it is the Agency'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.

I. 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

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

1. Summary of Significant Accounting Policies (Concluded)

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.

J. 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.

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, 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 Drinking 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.

Amounts Held by Trustee. The Nebraska Investment Finance Authority (NIFA) (the "Issuer") issues revenue bonds, the proceeds which are used by the Agency to provide the 20% match requirements for the Agency's Federal Capitalization Grants (See Note 4, Bonds Payable, for more details on these bonds). Wells Fargo Bank, N.A. (Trustee), as Trustee, establishes the appropriate accounts and invests the monies in accordance with the Bond Indenture. At June 30, 2012, the amount held by the Trustee of $10,703,383

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

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
Money Market Account	$	3,449,506
Guaranteed Investment Contracts (GICs) in CDC Funding Corporation		7,253,877
TOTAL	$	10,703,383

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 $3,449,506 in deposits held by the Trustee, $250,000 was covered by FDIC insurance and $3,199,506 was uninsured and uncollateralized during and at the end of the fiscal year ended June 30, 2012, 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 1.01 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;

(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), (b), or (e) 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;

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

(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 personal 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.

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 was unrated by Standard & Poor's Rating Group and Moody's Investors Services Inc.

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

- 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, 2012, the Program had 126 outstanding balances totaling $96,284,083. The outstanding balances of the ten communities with the largest loan balances, which represent 57% of the total loans, were as follows:

Community	Outstanding Balance
Kearney	$ 9,438,321
McCook	7,687,418
Gering	6,439,083
North Platte	6,095,888
Metropolitan Utilities District	5,288,244
Sidney	5,230,733
Auburn	4,292,627
Blair	4,145,564
Alliance	3,836,373
Beaver Lake Association	2,428,346
TOTAL	$ 54,882,597

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

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, 2004A, 2007A, 2008A, and 2010A Bonds are limited obligations of NIFA, payable only from and secured only by the Trust Estate. The Series 2000A, 2004A, 2007A, 2008A, and 2010A Bonds are revenue bonds. The Series 2000A, 2004A, 2007A, 2008A, and 2010A 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, 2004A, 2007A, 2008A, and 2010A Bonds. The current bonds payable amount was determined using the amount of bond principal to be retired in fiscal year 2013. Bonds payable for the fiscal year ended June 30, 2012, is as follows:

	Beginning Balance	Additions	Retirement	Ending Balance	Current Portion
Bonds Payable	$ 16,220,000	$ -	$ 6,590,000	$ 9,630,000	$ 970,000

Bonds payable at June 30, 2012, consist of the following:

Series	Original Issue	Retirements	2012 Balance	Interest Rate	Final Maturity Date
2000A	$ 5,530,000	$ 3,235,000	$ 2,295,000	4.8-5.7%	July 1, 2015
2004A	1,890,000	765,000	1,125,000	1.6-4.75%	July 1, 2019
2007A	1,920,000	450,000	1,470,000	3.5-4.35%	Jan. 1, 2022
2008A	1,965,000	335,000	1,630,000	2.75-5.0%	Jan. 1, 2023
2010A	3,110,000	-	3,110,000	0.9-4.0%	July 1, 2025

The 2000A Series Bonds were issued June 29, 2000, the 2004A Series Bonds were issued September 16, 2004, the Series 2007A Bonds were issued September 28, 2007, the Series 2008A Bonds were issued October 3, 2008, and the Series 2010A Bonds were issued November 12, 2010. Bonds mature at various intervals through July 2025. On July 1, 2011, the Agency redeemed series 2001A, 2002A, 2003A, 2005A, 2006A bonds in the principal amount of $5,725,000 and accrued interest in the amount of $124,123. The debt service requirements on bonds maturing in subsequent years are as follows:

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

4. Bonds Payable (Concluded)

Year Ending June 30	Principal	Interest	Total
2013	$ 970,000	$ 388,589	$ 1,358,589
2014	1,005,000	350,238	1,355,238
2015	1,030,000	308,896	1,338,896
2016	1,625,000	248,569	1,873,569
2017-2021	3,220,000	737,988	3,957,988
2022-2026	1,780,000	162,963	1,942,963
TOTAL	$ 9,630,000	$ 2,197,243	$ 11,827,243

Federal arbitrage regulations are applicable to these bonds.

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	$ 16,885	$ 2,187	$ 1,182	$ 17,890	$ 1,252

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 EPA 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 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
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	-

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

6. Net Assets (Concluded)

Federal Fiscal Year Available	Grant Amount	Amount Drawn	Balance
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	8,229,000	-
2008	8,146,000	8,146,000	-
2009 ARRA	19,500,000	19,057,539	442,461
2009	8,146,000	7,382,539	763,461
2010	13,573,000	6,828,669	6,744,331
2011	9,418,000	1,124,131	8,293,869
TOTAL	$ 150,841,726	$ 134,597,604	$ 16,244,122

The 2011 grant was delayed and was not awarded until September 17, 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	$ 129,957,118
Contributed During the Year:	
Funds From EPA	8,320,272
Funds From ARRA	278,050
Contributed Capital June 30, 2012	$ 138,555,440

Also included in the Contributed Capital is a total of all general funds received by the Program from the Legislature of the State of Nebraska. These assets were to be used as match for the Program for the initial capitalization grant received by the State. The State contributed $1,162,318 and $1,166,518 in the fiscal years ended June 30, 1998, and 1999, respectively. The State also used $1,629,000 of Administrative Cash Funds to provide the match for the 2009 capitalization grant during the fiscal year ended June 30, 2010.

7. 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.

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

8. 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.

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% Administrative Costs from Grant
- 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.

Following is an explanation of these categories:

4% Administrative Costs from Grant

A state may use up to 4 percent of the grant funds awarded 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 authority and use it for administrative costs in later years.

9. Operating Expenses (Continued)

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 the grant funds awarded 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 grant award, it can bank the excess authority and use it for the same activities in later years. A state may use these funds to support a technical assistance team or to contract with outside organizations to provide technical assistance.

10% Public Water Supply System

A state may use up to 10 percent of the grant funds awarded 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.

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

9. Operating Expenses (Concluded)

30% Loan Forgiveness

The amount of expenses reported as Loan Forgiveness is the amount the State subsidized principal payments on 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 loan forgiveness; however, the grant had different forgiveness regulations than annual base Drinking Water grants. 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 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 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.

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 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.

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

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 $8,367 and the Agency contributed $13,474. 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.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:

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.

11. Contingencies and Commitments (Concluded)

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. Subsequent Event

On January 1, 2013, the Agency redeemed series 2004A and 2007A bonds in the principal amount of $2,345,000.

13. 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 Flows From Operating Activities to Cash Flows From Non-Capital Financing Activities.

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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, 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 – 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

Management of the Nebraska Department of Environmental Quality – Drinking 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 – Drinking Water State Revolving Fund Program's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program's internal control over financial reporting.

A *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 – 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 certain matters 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 1 (Aid Testing), Comment Number 2 (Contractual Expenditures), Comment Number 3 (Cash Management), and Comment Number 4 (Federal Reporting).

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 responses 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 – 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

March 27, 2013

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

Compliance

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, 2012. 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.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the *U.S. Environmental Protection Agency Audit Guide for Clean Water and Drinking Water State Revolving Fund Programs.* Those standards require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on the Program occurred. An audit includes examining, on a test basis, evidence about the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program's compliance with those requirements.

In our opinion the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program complied, in all material respects, with the 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 (Aid Testing), Comment Number 2 (Contractual Expenditures), Comment Number 3 (Cash Management), and Comment Number 4 (Federal Reporting).

Internal Control Over Compliance

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 applicable to Federal programs. 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 to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance 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 – Drinking 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 – Drinking 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 – Drinking 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