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

JULY 1, 2012 THROUGH JUNE 30, 2013

Issued on April 22, 2014

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

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NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

BACKGROUND

The Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program (Program) was established pursuant to the Federal Safe Drinking Water Act of 1996. The Drinking Water State Revolving Fund Act is set out at Neb. Rev. Stat. §§ 71-5314 to 71-5327 (Reissue 2009, Cum. Supp. 2012). The Program has been established pursuant to both the Federal Safe Drinking Water Act and State statutes 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 with some forgiveness 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 may choose to have up to 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% of the Federal capitalization grant as matching funds in order to receive a Federal grant. As of June 30, 2013, the EPA had awarded $140 million in capitalization grants to the State, plus $19.5 million in American Recovery and Reinvestment Act (ARRA) funds. The award of this $140 million required the State to contribute approximately $28 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 Nebraska Department of Environmental Quality (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%). On January 1, 2013, the Agency retired the 2004 and 2007 bond issues. After the retirement of these bonds, $364,390 remained of reserve funds. These reserve funds, along with $1,430,610 of Administrative Cash Funds, were used to match the 2012 capitalization grant for a total of $1,795,000 ($8,975,000 x 20%). Of the $8,975,000 awarded, $358,500 was withheld by EPA as an in-kind contribution for funds to pay for a Federally contracted computer system (LGTS), which would track loans and program requirements. The system is still in a development stage.

The Program is administered by the 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.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

EXIT CONFERENCE

An exit conference was held April 4, 2014, 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
Kevin Nelson, CPA	DHHS Internal Audit Administrator
Steve McNulty	DHHS Engineer II
Tom Lamberson	DEQ Deputy Director
Pat Rice	DEQ Interim Director
Jack Daniel	DHHS Administrator I
Jim Novotny	DEQ Accountant III
Stephanie Vap-Morrow	DEQ Environmental Assistance Coordinator
Curtis Youngman	DAS State Finance Systems and Reports Coordinator
Steve Rowell	DEQ Environmental Engineer III
Kevin Stoner	DEQ Environmental Quality Section Supervisor
John R. Danforth	DEQ Environmental Assistance Coordinator
Kris Young	DEQ Accountant III
Mary Brady	DEQ Federal Aid Administrator II
Marty Link	DEQ Environmental Quality Associate Program Director
Martie Guthrie	DEQ Budget Officer III
Mark Herman	DEQ Federal Aid Administrator II

SUMMARY OF COMMENTS

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

1. ***Transparency Act Reporting*:** During testing of three subawards required to be reported under the Federal Funding Accountability and Transparency Act, it was noted that the required data elements were not correctly entered, and the subawards were not reported timely. Additionally, the Agency did not have procedures in place to review those subawards reported to ensure the data entered was accurate and in compliance with Federal regulations.

More detailed information on the above item is provided hereafter. It should be noted this report is critical in nature, containing only our comment and recommendation on the area noted for improvement.

Draft copies of this report were furnished to the Agency to provide its management with an opportunity to review and to respond to the comment and recommendation contained herein. The formal response received has been incorporated into this report. A response that indicates corrective action has been taken was not verified at this time, but it will be verified in the next audit.

COMMENT AND RECOMMENDATION

1. Transparency Act Reporting

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

Grant Number & Year: #FS-99780512-0, FFY2012; #FS-99780511-0, FFY2011

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

Criteria: Per Appendix C of the *Open Government Directive – Federal Spending Transparency and Subaward and Compensation Data Reporting,* dated August 27, 2010, the subaward obligation/action date is the date the subaward agreement was signed. The subaward number is the identifying number assigned by the prime awardee organization to facilitate the tracking of its subawards. The subaward date represents the time period (by month and year) for subawards made against that Federal Award Identifier Number (FAIN).

2 CFR § 170 (January 1, 2013) provides guidance to agencies on establishing requirements for recipients' reporting of information on subawards, as required by the Federal Funding Accountability and Transparency Act (FFATA). Appendix A, § I (a)(2), of that Federal regulation states:

> *i. You must report each obligating action described in paragraph a.1. of this award term to http://www.fsrs.gov.*
>
> *ii. For subaward information, report no later than the end of the month following the month in which the obligation was made. (For example, if the obligation was made on November 7, 2010, the obligation must be reported by no later than December 31, 2010.)*

Per OMB Circular A-133, § ___ .300(b) the 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 obligations meeting the requirements of 2 CFR § 170 guidance on FFATA are reported accurately and timely in the FFATA Subaward Reporting System (FSRS) and reflected on the USAspending website. Additionally, a good internal control plan requires procedures to ensure the sources of required data elements are consistent.

Condition: The Agency did not comply with all Federal regulations relating to the guidance on FFATA reporting.

Questioned Costs: None

Context: The APA tested three subawards that were required to be reported under the Transparency Act and noted the following:

COMMENT AND RECOMMENDATION
(Continued)

1. Transparency Act Reporting (Continued)

- One of three subawards tested did not have the correct subaward obligation date. The date of the Federal award from the EPA was entered rather than the subaward date.
- For two of the three subawards tested, the subaward date was reported as the month and year the report was filed, but it should have been the date the subrecipient could start spending the funds.
- One of the three subawards tested was not reported in FSRS; therefore, it did not show up on the USAspending website. Per the Agency, the subgrantee's Data Universal Numbering System (DUNS) was not tied to a congressional district, so the award was unable to be entered into the FSRS. The Agency attempted to enter the subaward during the APA's fieldwork, and the report was entered successfully. The subaward was reported 249 days late.
- One of the three subawards was shown on the USAspending website more than once.
- The Agency did not review the FSRS or the USAspending website to ensure subawards were appropriately entered, as required.
- The Agency used the subaward signature date as the subaward obligation date for Clean Water grants, while for Drinking Water grants the Agency used the subaward contract date as the subaward obligation date.

Cause: The Agency failed to establish adequate internal controls over its FFATA reporting process.

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

Recommendation: We recommend the Agency implement procedures to ensure required data for the FFATA is entered correctly and on time in the FSRS and on the USAspending website in compliance with Federal requirements. Additionally, we recommend the Agency implement a monthly review of FFATA data entered to ensure data elements are accurately reported and that subawards are only reported once. Finally, we recommend that the Agency determine a consistent method for reporting the subaward obligation date that is in compliance with Federal requirements.

COMMENT AND RECOMMENDATION
(Continued)

1. Transparency Act Reporting (Concluded)

Management Response: *The electronic system provided to enter FFATA reporting information into had several problems when it was deployed. Screens locked up, there were no search capabilities, and changes or updates created additional reports and entries that were not desired. Many of those elements have been improved, but initially our entry into the system was by trial and error. Due to the unique characteristics of the SRF Program and corresponding loan contracts, some of the decisions on dates and amounts to use for reporting were not clear. EPA helped to explain what was expected, and the Agency made those changes in an effort to comply with the FFATA Federal regulation.*

Corrective Action: *The Agency will evaluate the procedures it uses for FFATA compilation and data entry, to make sure there is consistency in application, that all data is collected, and ensuring information is submitted in a timely manner. Communication of these procedures will be made to SRF program staff once determined.*

Contact: *Stephanie Vap-Morrow*

Anticipated Completion Date: *May 31, 2014*

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NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

INDEPENDENT AUDITOR'S REPORT

Nebraska Department of Environmental Quality
Lincoln, Nebraska

Report on the Financial Statements

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, 2013, and the related notes to the financial statements, 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.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective balance sheet of the business-type activities of the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program, as of June 30, 2013, and the respective changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

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 balance sheet, the 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 – Drinking Water State Revolving Fund Program. They do not purport to, and do not, present fairly the balance sheet of the Nebraska Department of Environmental Quality as of June 30, 2013, the changes in its financial position, or its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 10 through 12 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.

Other Reporting Required by *Government Auditing Standards* and Regulatory Requirements

Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated April 11, 2014, on our consideration of the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, 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* in considering the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program's internal control over financial reporting and compliance.

Regulatory Requirements

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 April 11, 2014, 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.

Don Dunlap

Lincoln, Nebraska
April 11, 2014

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, 2013. 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 Position; 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 position. The Statement of Revenues, Expenses, and Changes in Net Position presents information showing how the Program's net position 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 Position

For the fiscal year ended June 30, 2013, the net position of the Program increased by 8%. Operating revenues for the Program decreased by 2%, while operating expenses decreased by 26%.

NET POSITION

	2013	2012 (As Restated)	% Change
Current Assets	$ 59,924,580	$ 57,565,067	4%
Noncurrent Assets	85,238,213	80,697,424	6%
Total Assets	145,162,793	138,262,491	5%
Current Liabilities	1,367,728	1,806,106	-24%
Noncurrent Liabilities	5,584,055	8,676,638	-36%
Total Liabilities	6,951,783	10,482,744	-34%
Net Position:			
Restricted	1,019,143	1,693,008	-40%
Unrestricted	137,191,867	126,086,739	9%
Total Net Position	$ 138,211,010	$ 127,779,747	8%

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

CHANGES IN NET POSITION

	2013	2012 (As Restated)	% Change
Loan Fees Administration	$ 927,572	$ 984,120	-6%
Interest	3,757,905	3,775,439	-1%
Fines, Forfeits & Penalties	-	2,131	-100%
Total Operating Revenues	4,685,477	4,761,690	-2%
Administration & Set-Asides	2,279,006	2,442,052	-7%
ARRA Loan Forgiveness	-	197,585	-100%
Non-ARRA Loan Forgiveness	1,483,094	2,469,043	-40%
Total Operating Expenses	3,762,100	5,108,680	-26%
Operating Income (Loss)	923,377	(346,990)	366%
Capital Contributions Federal Grants	9,480,740	8,510,580	11%
Capital Contributions ARRA Grants	346,857	373,654	-7%
Interest Expenses on Bonds	(319,711)	(407,026)	-21%
Net Nonoperating Revenue (Expense)	9,507,886	8,477,208	12%
Change in Net Position	10,431,263	8,130,218	28%
Beginning Net Position July 1	127,779,747	119,649,529	7%
Ending Net Position June 30	$ 138,211,010	$ 127,779,747	8%

The most significant changes from the fiscal year ended June 30, 2012, to the fiscal year ended June 30, 2013, were the Administration and Set-Asides and Non-ARRA Loan Forgiveness balances, Change in Net Position, and the amount received from Capital Contributions. The final amount of ARRA funding was paid out in fiscal year 2013, which was minimal compared to prior years. Administrative and Set-Aside expenses decreased from last fiscal year, due to the fact the Program did not issue bonds for the required grant match; thus, the typical administrative and/or legal costs associated with that activity were not incurred. Non-ARRA Loan Forgiveness also decreased, which was a result of the types and make-up of loans paid out during the year. Forgiveness dollars were awarded per grant requirements, but were not necessarily paid out on an annual basis. Due to several bond redemptions in the current and previous years, the cash balance has increased significantly. This has resulted in a higher Net Position balance. Capital contributions, in large part, are related to the loan amounts being paid to communities during construction. During the fiscal year, there was more demand for grant dollars to pay for construction loans and, therefore, an increase in Capital Contributions Federal Grants.

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

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 Program and are expected when draws are based on community requests.

ECONOMIC OUTLOOK

Net State General Fund revenues for fiscal year 2013 finished the year 7.6% 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 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, 2013, the Program had received $19,500,000 in ARRA funds, and about half of those funds were provided as principal forgiveness to communities. The ARRA funding did 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 included above in the line titled Noncurrent Liabilities in the Net Position 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.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM
BALANCE SHEET
JUNE 30, 2013

		Enterprise Fund
ASSETS		
CURRENT ASSETS:		
Cash and Cash Equivalents:		
Cash in State Treasury (Note 2)	$	41,050,227
Amounts Held by Trustee (Note 2)		9,965,770
Due from Federal Government		215,576
Interest Receivable		69,516
Loans Receivable (Note 3)		8,623,491
TOTAL CURRENT ASSETS		59,924,580
NON-CURRENT ASSETS:		
Loans Receivable (Note 3)		85,238,213
TOTAL NON-CURRENT ASSETS		85,238,213
TOTAL ASSETS	$	145,162,793
LIABILITIES		
CURRENT LIABILITIES:		
Accounts Payable & Accrued Liabilities	$	262,094
Due to Grant Recipients (Note 1)		221,631
Compensated Absences (Note 5)		1,434
Accrued Bond Interest Payable		132,569
Bonds Payable (Note 4)		750,000
TOTAL CURRENT LIABILITIES		1,367,728
NON-CURRENT LIABILITIES:		
Compensated Absences (Note 5)		19,055
Bonds Payable (Note 4)		5,565,000
TOTAL NON-CURRENT LIABILITIES		5,584,055
TOTAL LIABILITIES		6,951,783
NET POSITION		
Restricted for Bond Payments		1,019,143
Unrestricted		137,191,867
TOTAL NET POSITION		138,211,010
TOTAL LIABILITIES AND NET POSITION	$	145,162,793

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 POSITION

For the Year Ended June 30, 2013

	Enterprise Fund
OPERATING REVENUES:	
Loan Fees Administration (Note 7)	$ 927,572
Interest on Loans	2,325,298
Interest on Fund Balance - Trustee	512,936
Interest on Fund Balance - State Operating Investment Pool (Note 8)	919,671
TOTAL OPERATING REVENUES	4,685,477
OPERATING EXPENSES:	
Administrative Costs from Fees (Note 9)	486,262
15% Source Water Assessment Program (Note 9)	610,399
2% Technical Assistance to Small Systems (Note 9)	221,077
10% Public Water Supply System (Note 9)	961,268
Loan Forgiveness (Note 9)	1,483,094
TOTAL OPERATING EXPENSES	3,762,100
OPERATING INCOME	923,377
NONOPERATING REVENUE (EXPENSE)	
Capital Contributions - Federal Grants (Note 6)	9,480,740
Capital Contributions - ARRA Federal Grants (Note 6)	346,857
Interest Expense - State Match Bonds	(319,711)
NET NONOPERATING REVENUE (EXPENSE)	9,507,886
CHANGE IN NET POSITION	10,431,263
TOTAL NET POSITION, BEGINNING OF YEAR - As restated (Note 12)	127,779,747
TOTAL NET POSITION, END OF YEAR	$ 138,211,010

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, 2013

		Enterprise Fund
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts From Customers	$	18,956,093
Interest on Investments		1,424,431
Payments to Borrowers		(12,933,987)
Payments to Borrowers ARRA		(346,857)
Payments for Administration		(485,028)
Payments for 15% Source Water Assessment Program		(560,365)
Payments for 2% Technical Assistance to Small Systems		(267,044)
Payments for 10% Public Water Supply System		(1,015,364)
Payments for Loan Forgiveness		(1,485,780)
Payments for Loan Forgiveness ARRA		(95,604)
NET CASH PROVIDED BY OPERATING ACTIVITIES		3,190,495
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:		
Funds Received From the Environmental Protection Agency		9,455,473
Funds Received From the Environmental Protection Agency - ARRA Funds		442,461
Bond Principal Payments		(3,315,000)
Bond Interest Payments		(388,589)
NET CASH FROM NON-CAPITAL FINANCING ACTIVITIES		6,194,345
Increase in Cash and Cash Equivalents		9,384,840
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR		41,631,157
CASH AND CASH EQUIVALENTS, END OF YEAR	$	51,015,997
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating Income	$	923,377
ADJUSTMENTS TO RECONCILE OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
(Increase)/Decrease in Loans Receivable		2,422,379
(Increase)/Decrease in Interest Receivable		(8,177)
Increase/(Decrease) in Accounts Payable & Accrued Liabilities		(51,393)
Increase/(Decrease) in Compensated Absences		2,599
Increase/(Decrease) in Due to Grant Recipients		(98,290)
NET CASH PROVIDED BY OPERATING ACTIVITIES	$	3,190,495

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

NOTES TO THE FINANCIAL STATEMENTS

For the Fiscal Year Ended June 30, 2013

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 Program 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 also considered all potential component units for which it is financially accountable and other organizations that are fiscally dependent on the Program or whose relationship with the Program is so significant that exclusion would be misleading or incomplete. The Governmental Accounting Standards Board (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. The Agency is also considered financially accountable if an organization is fiscally dependent on, and there is potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the Agency, regardless of whether the organization has (1) a separately elected governing board, (2) a governing board appointed by a higher level of government, or (3) a jointly appointed board.

These financial statements present the Nebraska Department of Environment 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.

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

1. Summary of Significant Accounting Policies (Continued)

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 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 State accounting system includes the following Program 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 has 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 it 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 under 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.

1. Summary of Significant Accounting Policies (Continued)

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 position.

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.

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, 2013, 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, which 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. 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. After the final disbursement has been made, the amortization schedule identified in the loan agreement is adjusted for the actual amounts disbursed and for accrued interest during the project period. The interest rates on loans range from 2.0% to 4.3%, and the terms could be 5 to 20 years. Disadvantaged communities may have up to 30 years to repay.

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

1. Summary of Significant Accounting Policies (Continued)

The Program loans are funded from Federal capitalization grants, State match funding, and the Drinking Water State Revolving Fund. The grants are funded on average 83.33% from Federal funds and 16.67% from State match funds. The Drinking Water State Revolving Fund is financed through principal repayments plus interest earnings becoming available to finance new projects, allowing the funds to "revolve" over time.

The current loans receivable amount was determined using the amount of principal payment due to the Program at June 30, 2013, which is collectible in fiscal year 2014. Loans receivable that were paid in full, prior to their due date, as of December 31, 2013, were included in the current loans receivable balance.

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 Position

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 position is reported as restricted when resources 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, as required by the bond agreement.

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 be 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 currently eligible to receive termination payments and other employees expected to become eligible in the future to receive such payments upon termination, are included.

1. Summary of Significant Accounting Policies (Continued)

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 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% of the employee's accumulated sick leave. Employees under certain labor contracts can only be paid a maximum of 60 days.

The Program's 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. Due to Grant Recipients

Planning Grants for Preliminary Engineering Reviews are awarded through the Federal Capitalization Grant 15% set-aside funds. The Program awards Planning Grants to communities with populations below 10,000 where the Public Water System is operated by a political subdivision. Available grants are given upon evidence that the eligible Public Water System has entered into a contract with a professional engineer to develop a preliminary engineering report. Planning Grants are intended to provide financial assistance to Public Water Systems for projects seeking funding through the Water Wastewater Advisory Committee common pre-application process. The grant covers 90% of the preliminary engineering report and other eligible costs and will require 10% matching funds from the Public Water System.

Source Water Protection Grants are also awarded through the Federal Capitalization Grant 15% set-aside funds. They are available for proactive projects geared toward protecting Nebraska's drinking water supplies and will address drinking water quality, quantity, security, and/or education. Eligible applicants are political subdivisions that operate a Public Water System serving a population of 10,000 or fewer.

The Program may choose to provide additional subsidization for municipalities in the form of loan forgiveness. Forgiveness funds will be targeted primarily to the highest ranked eligible projects on the Priority Funding Lists, those that address public health needs, or those that have the components to meet Green Project Reserve guidelines. The loan recipient will not be required to repay the portion of the loan principal that has been designated as loan forgiveness under the terms and conditions of the loan contract. Loan

1. Summary of Significant Accounting Policies (Concluded)

forgiveness is considered a grant for purposes of the financial statements, since repayment is not required.

For Planning Grants, Source Water Protection Grants, and Loan Forgiveness awards, once the municipality submits proof of payment to their vendors, they are reimbursed for their project costs by the Program. The Program's financial statements recognized the expense and accrued liability to the Program when the municipality incurred the project expense, which may not be in the same fiscal year as when costs were reimbursed by the Program.

K. 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 on 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. The 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, 2013. All interest revenue is allocated to the General Fund except allocations required by law to be made to other funds. All funds of the Program were designated for investment during fiscal year 2013. 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 of 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 Master Trust Indenture dated June 1, 2000. At June 30, 2013, the amount held by the Trustee of $9,965,770 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

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

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	$ 2,403,120
Guaranteed Investment Contracts	
(GICs) in CDC Funding Corporation	7,562,650
TOTAL	$ 9,965,770

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 $2,403,120 in deposits held by the Trustee, $250,000 was covered by FDIC insurance, and $2,153,120 was uninsured and uncollateralized during and at the end of the fiscal year ended June 30, 2013, 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) to (b), inclusive, of this definition, or a combination thereof;*

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

(e) *bonds, debentures, notes or other evidences of indebtedness issued by any state of the United States of America or any political subdivision thereof or any public authority or body or instrumentality thereof which constitute obligations described in Section 103(a) of the Code which have a fixed par*

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

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

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 the 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 Bonds, 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 States branch or agency of a foreign bank, which foreign bank consents to in personam jurisdiction and which has a long-term debt rating by Standard & Poor's and Moody's no lower than the rating on the Outstanding Bonds; or

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

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 CDC Funding Corporation GIC was rated A-1 by Standard & Poor's Rating Group.

- Custodial Credit Risk of Investments – Custodial credit risk of 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

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

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 76% 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, 2013, the Program had 121 outstanding community loans that totaled $93,861,704. The outstanding balances of the 10 communities with the largest loan balances, which represent 53.2% of the total loans, were as follows:

Community	Outstanding Balance
McCook	$ 7,459,026
Gering	6,293,935
Lincoln	5,821,427
North Platte	5,666,339
Metropolitan Utilities District	5,504,723
Sidney	4,644,655
Blair	4,368,394
Auburn	4,188,627
Alliance	3,662,301
Beaver Lake Association	2,282,664
TOTAL	**$ 49,892,091**

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 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, 2008A, and

4. Bonds Payable (Concluded)

2010A Bonds are limited obligations of NIFA, payable only from and secured only by the Trust Estate. The Series 2000A, 2008A, and 2010A Bonds are revenue bonds. The Series 2000A, 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 principal, premium, if any, or interest on the Series 2000A, 2008A, and 2010A Bonds. The current bonds payable amount was determined using the amount of bond principal to be retired in fiscal year 2014. Bonds payable for the fiscal year ended June 30, 2013, is as follows:

	Beginning Balance	Additions	Retirements	Ending Balance	Current Portion
Bonds Payable	$9,630,000	$ -	$3,315,000	$6,315,000	$750,000

Bonds Payable at June 30, 2013, consisted of the following:

Series	Original Issue	Retirements	2013 Balance	Interest Rate	Final Maturity Date
2000A	$5,530,000	$ 3,640,000	$1,890,000	4.8-5.7%	July 1, 2015
2008A	1,965,000	455,000	1,510,000	2.75-5.0%	Jan. 1, 2023
2010A	3,110,000	195,000	2,915,000	.9-4.0%	July 1, 2025

The 2000A Series Bonds were issued June 29, 2000, 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, and 2006A bonds in the principal amount of $5,725,000 and accrued interest in the amount of $124,123. On January 1, 2013, the Agency redeemed series 2004A and 2007A bonds in the principal amount of $2,345,000 and accrued interest in the amount of $52,444. The debt service requirements on bonds maturing in subsequent years are as follows:

Year Ending June 30	Principal	Interest	Total
2014	$ 750,000	$ 252,194	$ 1,002,194
2015	780,000	220,288	1,000,288
2016	1,350,000	170,135	1,520,135
2017	340,000	131,805	471,805
2018	355,000	121,093	476,093
2019-2023	1,965,000	391,756	2,356,756
2024-2026	775,000	47,100	822,100
TOTAL	$ 6,315,000	$ 1,334,371	$ 7,649,371

Federal arbitrage regulations are applicable to these bonds.

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

5. Noncurrent Liabilities

Changes in noncurrent liabilities for the year ended June 30, 2013, were as follows:

	Beginning Balance	Increases	Decreases	Ending Balance	Amounts Due Within One Year
Compensated Absences	$ 17,890	$ 2,599	$ -	$ 20,489	$ 1,434

6. Capital Contributions

Included in the net position is the total amount of capitalization grants drawn from the EPA by the Agency. The following summarizes the EPA capitalization grants awarded and drawn, as well as the remaining balance as of June 30, 2013. 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, 2013, and may have been drawn over multiple years.

Federal Fiscal Year Available	Grant Amount	Amount Drawn	Balance
1997	$ 12,824,000	$ 12,824,000	$ -
1998	7,121,300	7,121,300	-
1999	7,463,800	7,463,800	-
2000	7,757,000	7,757,000	-
2001	7,789,126	7,789,126	-
2002	8,052,500	8,052,500	-
2003	8,004,100	8,004,100	-
2004	8,303,100	8,303,100	-
2005	8,285,500	8,285,500	-
2006	8,229,300	8,229,300	-
2007	8,229,000	8,229,000	-
2008	8,146,000	8,146,000	-
2009 - ARRA	19,500,000	19,500,000	-
2009	8,146,000	8,100,557	45,443
2010	13,573,000	10,950,556	2,622,444
2011	9,418,000	4,081,143	5,336,857
2012	8,616,500	1,658,556	6,957,944
TOTAL	$159,458,226	$144,495,538	$14,962,688

The 2012 grant was delayed and was not awarded until August 15, 2012, after the end of State fiscal year 2012.

6. Capital Contributions (Concluded)

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

Contributed Capital July 1, 2012	
(Reduced by $1,629,000 of State match funds previously included)	$ 136,926,440
Contributed During the Year:	
Funds from EPA	9,480,740
Funds from ARRA	346,857
Contributed Capital June 30, 2013	$ 146,754,037

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. Included in the Funds from EPA and Funds from ARRA amounts is the net decrease in Due from Federal Government of $70,337.

Nebraska was awarded $19,500,000 in American Recovery and Reinvestment Act (ARRA) funds for upgrades to public water systems. ARRA provided new, one-time funding, which was combined with existing funds from the Drinking Water State Revolving Fund. ARRA required the State to use at least 50% of the funds provided by this grant to offer additional subsidization in the form of principal forgiveness.

7. Loan Fees Administration

To meet the long-term administrative needs of the program, an annual fee of up to 1% is charged against the outstanding principal on loans. These fees are not included in the loan principal. This fee is calculated on a semi-annual basis and billed when loan principal and interest payments are due. The fee is applied to all loans in accordance with Title 131 Nebraska Administrative Code Chapter 8 and the loan agreement.

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 Program are classified, for financial reporting purposes, into five categories. There were expenses related to three set-aside activities established under §1452 of the Safe Drinking Water Act. The three set-aside activities are:

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

A Memorandum of Understanding was entered into between the Agency and the Nebraska Department of Health and Human Services so that the Agency can carry out oversight and related activities of the Program. The Program provides funding to the Nebraska Department of Health and Human Services with the three set-asides noted above.

All set-asides 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 Loan Forgiveness and Administrative Costs from Fees.

The following is an explanation of these categories:

Administrative Costs from Fees

To meet the long-term administrative needs of the Program, an annual fee of up to 1% is charged against the outstanding principal on loans. This fee is deposited into a separate account and is used for administrative costs. Revenues from fees can be used to provide the capitalization grant match, loan forgiveness, or planning grants.

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

9. Operating Expenses (Concluded)

2% Technical Assistance to Small Systems

A State may use up to 2% 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% 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% of the grant funds awarded to:

- Administer the State Public Water System Supervision 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.

Loan Forgiveness

The amount of expenses reported as Loan Forgiveness is the amount of loan principal payments the State subsidized to communities meeting the definition of "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% of the amount of the capitalization grant for that year.

10. State Employees Retirement Plan (Plan)

The single-employer Plan became effective by statute on January 1, 1964. The Public Employees Retirement Board was created in 1971 to administer the Plan. 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 either to continue participation in the defined contribution option or to 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 are established and can only be amended by the Nebraska Legislature.

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

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

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, 2013, employees contributed $10,597, and the Agency contributed $16,531. 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 Financial Report (CAFR) also includes pension-related disclosures. The CAFR report 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 typically 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 $5,000,000 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, with various limits and deductibles, for physical damage and uninsured and underinsured motorists. 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 $31,000,000 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

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

11. Contingencies and Commitments (Concluded)

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. Restatement of Beginning Net Position

Beginning Net Position on the Statement of Revenues, Expenses, and Changes in Net Position decreased by $34,009 to reflect fiscal year ended 2012 unrecorded expenses of $319,921 and a related receivable, Due from Federal Government, of $285,912 that had not been reflected in the prior year.

NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

INDEPENDENT AUDITOR'S REPORT

Nebraska Department of Environmental Quality
Lincoln, Nebraska

We have audited, in accordance with the 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, the 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, 2013, and the related notes to the financial statements, which collectively comprise the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program's basic financial statements, and have issued our report thereon dated April 11, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a 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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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 from 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.*

The Nebraska Department of Environmental Quality's Response to the Finding

We noted a certain matter 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 (Transparency Act Reporting).

The Nebraska Department of Environmental Quality's response to the finding identified in our audit is described in the accompanying Comments Section of this report. The Nebraska Department of Environmental Quality's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Don Dunlap

Lincoln, Nebraska	Don Dunlap, CPA
April 11, 2014	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*

INDEPENDENT AUDITOR'S REPORT

Nebraska Department of Environmental Quality
Lincoln, Nebraska

Report on Compliance for the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program

We have audited the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program's compliance 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 could have a direct and material effect on the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program for the year ended June 30, 2013. 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; Davis Bacon; State Matching; Period of Availability of Funds; Suspension and Debarment; Program Income; Reporting; Subrecipient Monitoring; and Special Tests and Provisions.

Management's Responsibility
Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program.

Auditor's Responsibility
Our responsibility is to express an opinion on compliance for the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program based on our audit of

the types of compliance requirements referred to above. 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 and the Audit Guide 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 Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund 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 on compliance for the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program. However, our audit does not provide a legal determination of the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program's compliance.

Opinion on the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program

In our opinion, the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program for the year ended June 30, 2013.

Other Matters

The results of our auditing procedures disclosed an instance of noncompliance, which is 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 is described in the Comments Section of this report as Comment Number 1 (Transparency Act Reporting). Our opinion on the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program is not modified with respect to this matter.

The Nebraska Department of Environmental Quality's response to the noncompliance finding identified in our audit is described in the accompanying Comments Section. The Nebraska Department of Environmental Quality's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

Report on 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 types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program's internal control over compliance with the types of requirements that could have a direct and material effect on the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program 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 – 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. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

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 material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the *U.S. Environmental Protection Agency Audit Guide for Clean Water and Drinking Water State Revolving Fund Programs*. Accordingly, this report is not suitable for any other purpose.

Don Dunlap

Lincoln, Nebraska
April 11, 2014

Don Dunlap, CPA
Assistant Deputy Auditor