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

JULY 1, 2016, THROUGH JUNE 30, 2017

Issued on March 9, 2018

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

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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. The Drinking Water State Revolving Fund Act is set out at Neb. Rev. Stat. §§ 71-5314 to 71-5327 (Reissue 2009, Cum. Supp. 2016, Supp. 2017). 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 can have terms of repayment between 5 and 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, 2017, the EPA had awarded $194 million in capitalization grants to the State, plus $19.5 million in American Recovery and Reinvestment Act (ARRA) funds. The award of this $194 million required the State to contribute approximately $39 million in matching funds. Since the inception of the Program the State has appropriated $2.33 million to meet the State's matching requirement. Additional matching funds were obtained through the issuance of revenue bonds and the use of Administrative Cash Funds.

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, the Program's Intended Use Plan, loan interest rates, and revenue bonding amounts. The Nebraska Department of Health and Human Services – Division of Public Health sets the funding priorities.

KEY OFFICIALS AND AGENCY CONTACT INFORMATION

Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program Executive Management

Name	Title
Jim Macy	Director
Dennis Burling	Deputy Director
Ryan Phillips	Budget Officer III

Nebraska Department of Environmental Quality
1200 N Street, Suite 400
P.O. Box 98922
Lincoln, NE 68509
deq.ne.gov

SUMMARY OF COMMENTS

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

1. ***Financial Statement Errors:*** The Agency made errors in preparing its financial statements. Current loans receivable were overstated by $77,802, and non-current loans receivable were understated by the same amount. The accounts payable accrual entry omitted transactions, totaling $9,220, affecting multiple financial statement line items. Indirect costs, totaling $1,655, were not properly accrued, affecting multiple financial statement line items. The compensated absence accrual omitted two employees who worked on the Program, causing Accrued Compensated Absences and operating expenses to be understated by $2,171.

2. ***Insufficient Supporting Documentation:*** The Agency did not maintain documentation supporting timesheet approval of temporary employees, a batch posted in the State accounting system, review and follow-up procedures for outstanding warrants, or timesheets for one pay period.

More detailed information on the above items is provided hereinafter. It should be noted this report is critical in nature, containing only our comments and recommendations on the areas noted for improvement.

Draft copies of this report were furnished to the Department of Environmental Quality – Drinking Water State Revolving Fund Program to provide its management with an opportunity to review and to respond to the comments and recommendations contained herein. All formal responses received have been incorporated into this report. Responses that indicate corrective action has been taken were not verified at this time, but they will be verified in the next audit.

COMMENTS AND RECOMMENDATIONS

1. Financial Statement Errors

During our review of the Nebraska Department of Environmental Quality (Agency) – Drinking Water State Revolving Fund Program (Program) trial balance and financial statements, we noted the following errors:

- The Agency's split of loans receivable between current and non-current on the Balance Sheet was incorrect. The Agency's procedure is to reflect as current loans receivable any principle payments owed during the upcoming fiscal year, as well as any loans receivable that, as of August 31, 2017, were paid off prior to their due date. However, we noted the Agency received a principle payment in August 2017 that was included twice. As a result, current loans receivable was overstated by $77,802, and non-current loans receivable was understated by $77,802.

- When recording the accounts payable accrual for fiscal year 2017, the Agency omitted transactions coded to subprograms for capacity development and source water salaries. Additionally, one transaction coded to a revenue object account was also excluded. This resulted in the following financial statement errors:

    - Accounts Payable & Accrued Liabilities understated by $9,220.
    - Loan Fees Administration operating revenue overstated by $1,126.
    - 15% Source Water Assessment Program operating expenses understated by $8,094.
    - Due from Federal Government understated by $8,094.
    - Capital Contributions – Federal Grants understated by $8,094.

- The agency did not properly accrue indirect costs of $1,655 related to the June 26, 2017, through July 9, 2017, pay period. This caused the following errors: 1) Accounts payable was understated by $1,655; 2) Administrative Costs from Fees were understated by $1,204; and 3) 15% Source Water Assessment Program was understated by $451. Finally, Due from Federal Government and Capital Contributions – Federal Grants were both understated by $451.

- Two employees with time coded to the Program were incorrectly excluded from the compensated absence accrual calculation. The employees were on the compensated absence list in the prior year; however, after the Agency went through some reorganization, the employees were wrongly removed from the list. As a result, Accrued Compensated Absences and operating expenses were understated by $2,171.

The Auditor of Public Accounts (APA) discussed the identified issues with the Agency, and audit adjustments were made to correct errors when proposed by the APA.

A similar finding was noted during the previous audit.

A good internal control plan and sound accounting practices require procedures to ensure accounting estimates are accurate and complete for proper financial statement presentation. The absence of such procedures increases the risk of materially misstated financial statements.

COMMENTS AND RECOMMENDATIONS
(Continued)

1. Financial Statement Errors (Concluded)

> We recommend the Agency strengthen procedures to ensure accounting entries are proper and complete for accurate financial presentation.

Agency Response: The agency has established a checklist to allow for adequate time to prepare the financials, accrue payroll, and obtain approval from EPA so the proper indirect rate will be used for the corresponding fiscal year.

2. Insufficient Supporting Documentation

During our review of the Nebraska Department of Environmental Quality (Agency) – Drinking Water State Revolving Fund Program (Program) supporting documentation, we noted the following issues:

- Documentation of Agency supervisor approval of temporary employee timesheets was not maintained. Per discussion with the Accounting Clerk, the e-mails containing the approved hours are not kept after being processed.
- Documentation for one batch posted in the State accounting system and selected for testing was unable to be located. The batch was a journal entry changing coding for an earlier reimbursement made to a loan recipient. While the documentation for the reimbursement was observed, documentation for the coding change could not be located.
- Documentation supporting a review and follow-up procedures, if necessary, for outstanding warrants was not available or could not be located by the Agency.
- During payroll testing, one employee had no timecard information in the State accounting system for the pay period September 19, 2016, through October 2, 2016. Upon further review we noted timecard information for all Agency employees was missing from the accounting system for that pay period. Neither the Agency nor the Department of Administrative Services – State Accounting could explain the missing records.

Good accounting practices and internal controls require that sufficient documentation be maintained to support transactions. When supporting documentation is not maintained, there is an increased risk of incorrect or fraudulent expenditures.

Neb. Rev. Stat. § 84-1001(1) (Reissue 2014) states the following, in relevant part:

> *All state officers and heads of departments and their deputies, assistants, and employees, except permanent part-time employees . . . not required to render full-time service, shall render not less than forty hours of labor each week in which a paid holiday may occur.*

COMMENTS AND RECOMMENDATIONS
(Concluded)

2. Insufficient Supporting Documentation (Concluded)

Additionally, a good internal control plan requires that hours worked be adequately documented, via timesheets or time logs, etc., and such documentation be kept on file to provide evidence of compliance with § 84-1001(1). Furthermore, a good internal control plan also requires the maintenance of adequate documentation to support that accrued employee sick and vacation leave was actually earned.

> We recommend the Agency maintain all supporting documentation for transactions effecting the Program. Additionally, we recommend the Agency review the State accounting system to ensure timecard information is appropriately maintained and documented.

Agency Response: The agency has updated processes to require that temporary employee timesheet approvals be communicated by managers signing an approval form and attaching it to the employee's timesheet. Additional processes we updated by adding a signoff sheet to month end checklists so the outstanding warrants are not missed.

NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

Charlie Janssen
State Auditor

Charlie.Janssen@nebraska.gov
PO Box 98917
State Capitol, Suite 2303
Lincoln, Nebraska 68509
402-471-2111, FAX 402-471-3301
www.auditors.nebraska.gov

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, 2017, 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 previously 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, 2017, and 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.

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, 2017, 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 Matter

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 13 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, which 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 February 27, 2018, 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.

Report on Regulatory Requirements

In accordance with the *U.S. Office of Management and Budget (OMB) Compliance Supplement*, we have also issued our report dated February 27, 2018, 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.

Philip J. Olsen

Lincoln, Nebraska
February 27, 2018

Philip J. Olsen, CPA, CISA
Assistant Deputy Auditor

MANAGEMENT'S DISCUSSION AND ANALYSIS

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, 2017. 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 the following: 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 – ENTERPRISE FUND

Changes in Net Position

For the fiscal year ended June 30, 2017, the net position of the Program increased by 8.0% or $13,900,741. This occurred because the EPA requested that awarded Federal Grant funds be drawn on a first-in, first-out basis in fiscal year 2016 and fiscal year 2017, which resulted in $13.4 million in draws. If the Program had not obliged, the Program would have given up the capitalization grant.

Changes in Net Investment in Capital Assets

The fiscal year over year comparison represents the accumulated amount invested in the development of the Loan and Grant Tracking System (LGTS). In fiscal year 2016, the Program invested $68,036 in LGTS. In fiscal year 2017 an additional $29,440 was invested in LGTS software development.

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

BALANCE SHEET

	2017	2016	% Change
Current Assets	$ 109,366,113	$ 94,176,189	16.1%
Non-current Assets	78,725,652	80,341,978	-2.0%
Total Assets	**188,091,765**	**174,518,167**	**7.8%**
Current Liabilities	298,026	624,761	-52.3%
Non-current Liabilities	17,200	17,608	-2.3%
Total Liabilities	**315,226**	**642,369**	**-50.9%**
Net Position:			
Net Investment in Capital Assets	195,027	165,587	17.8%
Unrestricted	187,581,512	173,710,211	8.0%
Total Net Position	**$ 187,776,539**	**$ 173,875,798**	**8.0%**

CHANGES IN NET POSITION

	2017	2016	% Change
Loan Fees Administration	$ 814,175	$ 930,075	-12.5%
Interest on Loans	1,921,295	2,224,924	-13.7%
Total Operating Revenues	**2,735,470**	**3,154,999**	**-13.3%**
Administration & Set-Asides	2,273,814	2,639,946	-13.9%
Loan Forgiveness	1,976,428	1,999,024	-1.1%
Total Operating Expenses	**4,250,242**	**4,638,970**	**-8.4%**
Operating Income (Loss)	**(1,514,772)**	**(1,483,971)**	**-2.1%**
Federal Grants	13,399,738	10,896,814	23.0%
Interest Revenue	2,013,658	1,664,827	21.0%
Bond Expenses	2,117	-	100%
Total Non-Operating Revenue (Expense)	**15,415,513**	**12,561,641**	**22.7%**
Change in Net Position	**13,900,741**	**11,077,670**	**25.5%**
Beginning Net Position July 1	**173,875,798**	**162,798,128**	**6.8%**
Ending Net Position June 30	**$ 187,776,539**	**$ 173,875,798**	**8.0%**

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

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 collect the amount of user fees needed to fund infrastructure requirements.

DEBT ADMINISTRATION

Short-Term Debt

The Program had debt activity during the fiscal year that was short-term in nature resulting from a bond issue. The issue was for $665,000, which was repaid and retired within the same fiscal year.

LOANS AND GRANTS TRACKING SYSTEM SOFTWARE (LGTS)

LGTS is a comprehensive software application developed by Northbridge Environmental, which is designed for Nebraska's State Revolving Fund (SRF) managers and staff to track and manage all aspects of their Clean and Drinking Water SRF programs from project loan application to final repayment, as well as to track all capital contributions, set-aside spending, and bond issuance and repayment.

The software was developed to address the data management needs for all of the steps in the SRF management process, including priority list development, facility location and identification, engineering review and milestone tracking, inspections, contacts, contract approvals and change orders, detailed payment request processing, project spending forecasts, encumbrances, funding draws and transfers, disbursements, amortization schedule creation and management, billing, repayment processing, fund deposits, and tracking of repaid funds by their original source. The software also contains a general ledger that each state can customize to match existing accounting systems and create trial balances, financial statements, and related financial schedules.

LGTS has built-in role based security that requires users to log in each time they open the Program. This security system is based on defined roles that each user is playing in the Program. Security roles limit users to performing certain functions.

Historical data is extracted from spreadsheets or other data systems to load LGTS with data, test the validity of the data, and ensure that LGTS can be used effectively. This task is handled by a combination of staff efforts to assemble existing data sources and outside help to ensure that the data is used properly. This process usually yields a dual benefit of having a system with clean data and provides a quality assurance check of the many transactions that have occurred years ago and often by a number of staff members.

Nebraska's State Revolving Fund programs have begun implementation of the LGTS system. During fiscal year 2014, planning of the implementation phases, business rules, and hardware/software installations occurred. During fiscal year 2015 through 2017, the system was

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Concluded)

used concurrently with existing systems, to create a basis for reliability and consistency. Once dependable, reconciled results will be established, the existing internal system will be discontinued, and LGTS will become the sole system for use within the SRF Program alongside the State Accounting system.

Contract costs for the purchase and implementation of the LGTS system have been handled through the existing Northbridge contract with the Federal Environmental Protection Agency (EPA) procurement. Therefore, expenditures are withheld as an "in-kind" deduction to the total annual grant, which is awarded to the Program each year. The Federal EPA staff negotiate, monitor, and manage the Northbridge contract for LGTS.

The Agency is capitalizing the costs that the EPA reimburses directly to Northbridge, as well as the cost of staff time utilized for implementation.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM
BALANCE SHEET
June 30, 2017

	Enterprise Fund
ASSETS	
Current Assets:	
Cash and Cash Equivalents:	
Cash in State Treasury (Note 2)	$ 104,045,148
Due from Federal Government	204,291
Interest Receivable	176,693
Loans Receivable (Note 3)	4,939,981
Total Current Assets	109,366,113
NON-CURRENT ASSETS	
Loans Receivable (Note 3)	78,530,625
Capital Assets, Net (Note 4)	195,027
Total Noncurrent Assets	78,725,652
Total Assets	$ 188,091,765
LIABILITIES	
Current Liabilities:	
Accounts Payable & Accrued Liabilities	229,715
Due to Grant Recipients (Note 1)	66,610
Compensated Absences (Note 6)	1,701
Total Current Liabilities	298,026
Noncurrent Liabilities:	
Compensated Absences (Note 6)	17,200
Total Noncurrent Liabilities	17,200
Total Liabilities	$ 315,226
NET POSITION	
Net Investment in Capital Assets	195,027
Unrestricted	187,581,512
Total Net Position	187,776,539
Total Liabilities and Net Position	$ 188,091,765

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, 2017

		Enterprise Fund
OPERATING REVENUES:		
Loan Fees Administration (Note 8)	$	814,175
Interest on Loans		1,921,295
Total Operating Revenues	$	2,735,470
OPERATING EXPENSES:		
Administrative Costs from Fees (Note 10)		470,155
15% Source Water Assessment Program (Note 10)		581,146
2% Technical Assistance to Small Systems (Note 10)		118,163
10% Public Water Supply System (Note 10)		1,104,350
Loan Forgiveness (Note 10)		1,976,428
Total Operating Expenses	$	4,250,242
Operating Loss		(1,514,772)
NONOPERATING REVENUE (EXPENSE)		
Capital Contributions - Federal Grants (Note 7)		13,372,014
Capital Contributions - Federal Grants - Capital Assets		27,724
Interest on Fund Balance - State Operating Investment Pool (Note 9)		2,018,596
Interest Expense on Bonds Payable (Short-Term)		(4,938)
Net (Bond Issuance Costs) and Debt Service Refund		2,117
Net Nonoperating Revenues (Expenses)		15,415,513
Change in Net Position		13,900,741
NET POSITION, JULY 1		173,875,798
NET POSITION, JUNE 30	$	187,776,539

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, 2017

	Enterprise Fund
CASH FLOWS FROM OPERATING ACTIVITIES:	
Receipts From Customers	$ 23,239,924
Payments to Borrowers	(12,748,125)
Payments for Administration	(478,902)
Payments for 15% Source Water Assessment Program	(576,766)
Payments for 2% Technical Assistance to Small Systems	(127,458)
Payments for 10% Public Water Supply System	(1,051,932)
Payments for Loan Forgiveness	(2,343,453)
Net Cash Flows from Operating Activities	$ 5,913,288
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:	
Grants Received From the Environmental Protection Agency	13,758,017
Receipts from Bond Issue (Short-Term)	665,000
Repayment of Bond (Short-Term)	(665,000)
Bond Interest Payments	(4,938)
Debt Service Refunds	2,117
Net Cash Flows from Noncapital Financing Activities	13,755,196
CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES:	
Capital Contributions	27,723
Purchase of Capital Assets	(29,440)
Net Cash Flows from Capital Financing Activities	(1,717)
CASH FLOWS FROM INVESTING ACTIVITIES:	
Interest on Investments	1,981,471
Net Cash Flows from Investing Activities	1,981,471
Net Increase in Cash and Cash Equivalents	21,648,238
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	82,396,910
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 104,045,148
RECONCILIATION OF OPERATING INCOME TO NET CASH FLOWS FROM OPERATING ACTIVITIES:	
Operating Loss	$ (1,514,772)
Adjustments to reconcile operating income to net cash flows from operating activities:	
(Increase)/Decrease in Loans Receivable	7,755,203
Increase/(Decrease) in Accounts Payable & Accrued Liabilities	40,330
Increase/(Decrease) in Compensated Absences	(448)
Increase/(Decrease) in Payables to Grant Recipients	(367,025)
Total Adjustments	7,428,060
NET CASH FLOWS FROM OPERATING ACTIVITIES	$ 5,913,288

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

NOTES TO THE FINANCIAL STATEMENTS

For the Fiscal Year Ended June 30, 2017

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 (Trustee) 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 Program. No component units were identified. The Program is part of the primary government for the State of Nebraska's reporting entity.

C. Fund Structure

The Program's accounts are maintained in accordance with the principles of fund accounting to ensure compliance with limitations and restrictions placed on the use of resources available to it. Under fund accounting, individual funds are established for the purpose of carrying on activities or attaining objectives in accordance with specific

1. Summary of Significant Accounting Policies (Continued)

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

- Drinking Water Facilities Funds – Federal Funds 48416 and 48418; and Repaid Principle and Bond Funds 68481, 68482, 68483, 68484, and 68485.

- Drinking Water Administration Fund – Cash Fund 28630

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

The activity of these State of Nebraska funds 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.

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.

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

1. Summary of Significant Accounting Policies (Continued)

E. Cash and Cash Equivalents

Cash and Cash Equivalents – Cash and cash equivalents consist of cash in the State Treasury. This includes cash in bank accounts and petty cash, short-term investments, such as certificates of deposit, repurchase agreements, and U.S. treasury bills. These short-term investments have original maturities (remaining time to maturity at acquisition) of three months or less. These investments are stated at cost, which at June 30, 2017, approximates fair value due to their short-term nature. 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.

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. The interest rates on loans range from 2.0% to 4.0%, and the terms on outstanding loans range from 9.5 to 30 years. Disadvantaged communities may have up to 30 years to repay.

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. Reimbursements to communities are paid 100% from State matching funds until they have been exhausted, and then from Federal capitalization grant funds or Drinking Water State Revolving 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, 2017, which is collectible in fiscal year 2018. Loans receivable that were paid in full, prior to their due date, as of August 31, 2017, were included in the current loans receivable balance as opposed to the long-term loans receivable balances.

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

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

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. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at fiscal year end and revenues and expenses during the reporting period. Actual results could differ from those estimates.

H. Compensated Absences

All permanent employees working for the Program earn sick and annual leave and are allowed to accumulate compensatory leave rather than 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.

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 240 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 percent 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.

I. 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

1. Summary of Significant Accounting Policies (Continued)

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 are needed to address critical capacity development concerns. 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 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 vendor payment to the Agency, it is reimbursed for its 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.

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 operating revenues of the Program include loan fees administration and interest on loans, since making loans is the primary purpose of the Program. The operating expenses of the Program are administration and set-aside expenses and loan forgiveness.

K. Capital Assets

The Program has only one capital asset, the Loans and Grants Tracking System (LGTS) software, and it is recorded at cost. The Agency began the development phase of the LGTS software during the fiscal year ended June 30, 2014, and is anticipating this phase to be completed during the fiscal year ended June 30, 2018. The LGTS software is considered an intangible capital asset, and the Agency follows the capitalization policy set forth by the

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

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

State of Nebraska for intangible capital assets, which requires capitalization of such assets when the cost of such asset is in excess of $100,000 and has an expected useful life of greater than one year. The LGTS software has an estimated useful life of seven years. Depreciation/amortization will begin upon completion of the developmental phase and the software being put into production, and it will be computed using the straight-line method over the estimated useful life of the asset.

2. **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, 2017. 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 2017. Amounts are allocated on a monthly basis based on average balances of all invested funds.

3. **Loans Receivable**

As of June 30, 2017, the Program had 124 outstanding community loans that totaled $83,470,606. The outstanding balances of the 10 communities with the largest loan balances, which represent 50.2% of the total loans, were as follows:

Community	**Outstanding Balance**
Lincoln	$ 12,936,098
Sidney	5,924,476
MUD – Omaha	4,292,138
Auburn	3,826,399
Falls City	3,434,830
Alliance	2,930,313
Blair	2,551,099
Ogallala	2,117,687
Utica	2,011,470
Waverly	1,880,040
TOTAL	**$ 41,904,550**

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

4. Capital Assets

The Drinking Water SRF capital assets activity for the year ended June 30, 2017, was:

	Beginning Balance As Restated	Additions	Retirements	Ending Balance
Software Development In-Progress				
Loans and Grants Tracking System (LGTS)	$ 165,587	$ 29,440	$ -	$ 195,027

5. Bonds Payable

The State has entered into a special financing arrangement with the Nebraska Investment Finance Authority (NIFA), an independent instrumentality of the State exercising essential public functions, to provide matching funds for the Program. NIFA issues bonds, and the proceeds are held by the Trustee until they are needed by the Program for Loan Purposes.

The proceeds of short-term revenue bonds are used by the Agency to provide the 20% match requirements for the Agency's Federal Capitalization Grants. Interest revenue from Program loans was pledged to pay off the bonds. During the fiscal year, the Program utilized $1,000,000 of administrative cash funds and issued and retired Series 2016 short-term revenue bonds to meet their match requirements for the 2017 DWSRF grant. Bonds Payable activity for fiscal year 2017 on the short-term bond was as follows:

	Beginning Balance	Additions	Retirements	Ending Balance
Bonds Payable	$ -	$ 665,000	$ 665,000	$ -

6. Non-current Liabilities

Changes in non-current liabilities for the year ended June 30, 2017, were as follows:

	Beginning Balance	Increases	Decreases	Ending Balance	Amounts Due Within One Year
Compensated Absences	$ 19,349	$ -	$ 448	$ 18,901	$ 1,701

7. 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, 2017. 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, 2017, and may have been drawn over multiple years.

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

7. Capital Contributions (Concluded)

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	8,146,000	-
2010	13,573,000	13,573,000	-
2011	9,418,000	9,418,000	-
2012	8,695,558	8,695,558	-
2013	8,533,907	8,533,907	-
2014	8,845,000	8,845,000	-
2015	8,681,560	8,610,271	71,289
2016	8,280,275	7,593,714	686,561
2017	8,312,000	-	8,312,000
TOTAL	**$ 202,190,026**	**$ 193,120,176**	**$ 9,069,850**

Not included in the above grant totals are the amounts set aside as in-kind contributions for the Loans and Grants Tracking System (LGTS) software development. The 2012 grant had $166,535, the 2015 grant had $105,440, and the 2016 grant had $31,725 set aside as in-kind amounts for use by the EPA for the development of the new LGTS software.

The amount of in-kind contributions utilized for the LGTS software during the fiscal year ending June 30, 2017, was $29,440. The total amount utilized for LGTS as of June 30, 2017, was $195,027. Additional in-kind contributions were received and capitalized for the Clean Water State Revolving Fund Program, which also utilizes the LGTS software.

8. 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. This fee is not included in the loan principal. It is calculated on a semi-annual basis and billed when the loan principal and interest payments are due. The fee is applied to all loans in accordance with Title 131 Nebraska Administrative Code (NAC) Chapter 8 and the loan agreement.

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

9. 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.

10. 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 the following:

- 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 of the Program. 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:

- Provide 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;

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

10. Operating Expenses (Concluded)

- 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.

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 reserve 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 do the following:

- 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 total 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.

11. 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

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

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.

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 18 years may exercise the option to begin participation in the retirement system.

Contribution – Per statute, each member contributes 4.8% of his or her 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 will 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 will 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, 2017, employees contributed $11,449, and the Agency contributed $17,861. 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.

12. 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 the following:

A. Motor vehicle liability with vehicular pursuit, which is insured for the first $5,000,000 of exposure per accident with a self-insured retention of $300,000 and $300,000 corridor retention. Motor vehicle liability is insured for $1,000,000 with a self-insured retention of $200,000, and with excess coverage of $400,000,000. 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. There is a $5,000 deductible for this coverage.

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 $401,000,000, with a self-insured retention of $200,000 per loss occurrence. Newly acquired properties are covered up to $10,000,000 for 120 days, and after 120 days, if the property has not been reported, the limit decreases to $5,000,000. The perils of flood, earthquake, and acts of terrorism have various coverage, sub-limits, and self-insurance. State agencies have the option to purchase building contents and inland marine coverage.

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

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

NOTES TO THE FINANCIAL STATEMENTS
(Concluded)

12. Contingencies and Commitments (Concluded)

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.

NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

Charlie Janssen
State Auditor

Charlie.Janssen@nebraska.gov
PO Box 98917
State Capitol, Suite 2303
Lincoln, Nebraska 68509
402-471-2111, FAX 402-471-3301
www.auditors.nebraska.gov

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, 2017, 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 February 27, 2018.

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.*

Additional items

We noted certain additional items that we reported to management of the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program in the Comments Section of this report as Comment Number 1 (Financial Statement Errors) and Comment Number 2 (Lack of Supporting Documentation).

Nebraska Department of Environmental Quality's Response to Findings

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. The Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it. Where no response is indicated, the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program declined to respond.

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.

Philip J. Olsen

Lincoln, Nebraska	Philip J. Olsen, CPA, CISA
February 27, 2018	Assistant Deputy Auditor

NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

Charlie Janssen
State Auditor

Charlie.Janssen@nebraska.gov
PO Box 98917
State Capitol, Suite 2303
Lincoln, Nebraska 68509
402-471-2111, FAX 402-471-3301
www.auditors.nebraska.gov

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 OMB COMPLIANCE SUPPLEMENT

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 *OMB Compliance Supplement* 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, 2017.

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 audit requirements of Title 2 U.S. Code of

Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance 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, 2017.

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 Uniform Guidance, 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 Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

Philip J. Olsen

Lincoln, Nebraska
February 27, 2018

Philip J. Olsen, CPA, CISA
Assistant Deputy Auditor