

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

JULY 1, 2008 THROUGH JUNE 30, 2009

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Issued on June 2, 2010

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

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NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

BACKGROUND

The Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program (Program) was established pursuant to the Federal Safe Drinking Water Act of 1996. Neb. Rev. Stat. §§ 71-5314 to 71-5327 created the Drinking Water State Revolving Fund Act. The Federal Safe Drinking Water Act and State statutes established the Drinking Water State Revolving Fund Program to provide loans, at reduced interest rates, to finance the construction of publicly and privately owned drinking water facilities. Instead of making grants to communities that pay for a portion of the building of drinking water facilities, the Program provides for low interest loans to finance the entire cost of qualified projects. The Program provides a flexible financing source which can be used for a variety of projects. Loans made by the Program must be repaid within 20 years, and all repayments, including interest and principal, must be used for the purposes of the Program. Disadvantaged communities have 30 years to repay all loans.

The Program was capitalized by the United States Environmental Protection Agency (EPA) by a series of grants starting in 1997. States are required to provide an additional 20 percent of the Federal capitalization grant as matching funds in order to receive a Federal grant. As of June 30, 2009, the EPA had awarded \$100 million in capitalization grants to the State. The award of this \$100 million required the State to contribute approximately \$20 million in matching funds. The State provided appropriations to contribute \$2.33 million of the funds to meet the State's matching requirement. Additional matching funds were obtained through the issuance of revenue bonds of \$5,530,000 in June 2000, \$1,815,000 in March 2001, \$2,000,000 in December 2002, \$1,700,000 in June 2003, \$1,890,000 in September 2004, \$1,920,000 in August 2005, \$1,915,000 in June 2006, \$1,920,000 in September 2007, and \$1,965,000 in October 2008.

The Program is administered by the Nebraska Department of Environmental Quality (Department) and the Nebraska Department of Health and Human Services – Division of Public Health. The Department's primary activities with regard to the Program include the making of loans for facilities and the management and coordination of the Program. The Nebraska Environmental Quality Council approves the rules and regulations of the Department and the Program's Intended Use Plan. The Nebraska Department of Health and Human Services – Division of Public Health sets the funding priorities.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

EXIT CONFERENCE

An exit conference was held May 18, 2010, with the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program to discuss the results of our examination. Those in attendance for the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program were:

NAME	TITLE
Tom Lamberson	Deputy Director
Martie Guthrie	Budget Officer III
Kris Young	Accountant III
Mark Herman	Federal Aid Administrator II
Jan Worster	Federal Aid Administrator II

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
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SUMMARY OF COMMENTS

During our audit of the Nebraska Department of Environmental Quality (Department) - 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. ***Loans Receivable Reconciliation:*** The Department did not reconcile their internal Drinking Water loan records to the Nebraska Information System (NIS) at June 30, 2009. Additionally, errors were noted in the posting of loan repayments which resulted in incorrect loans receivable balances at the borrower level.
2. ***Financial Statement Errors:*** Errors were noted in the financial information prepared by the Department's accounting staff. Errors were noted on the trial balance prepared by the Department. Trial balance amounts are carried forward to the financial statements.

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

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

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

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

COMMENTS AND RECOMMENDATIONS

1. Loans Receivable Reconciliation

A good internal control plan requires the Nebraska Information System (NIS) loans receivable data be reconciled to the Department's internal loans receivable records to ensure loan activity was recorded accurately and NIS loans receivable balances are accurate.

- The Department did not reconcile their internal Drinking Water loan records to NIS at June 30, 2009. The Loans Receivable balance was \$70,012,995 at June 30, 2009.
- Two of fifteen NIS loans receivable balances tested did not agree to the final loan amortization schedules. NIS showed a loan receivable balance of \$806,038 for Boyd County which should have been \$706,038. Boyd County had made an additional \$100,000 principal payment that was not credited to the loan in NIS. NIS showed a loan receivable balance of \$88,939 for Stamford, which should have been \$87,770. Stamford had made a loan payment of \$1,169 that was credited to Ceresco instead of Stamford in NIS.
- Drinking Water principal repayments of \$124,838 were entered into NIS; however, the repayments of \$100,000 from Boyd County and \$24,838 from Ceresco were not credited to any loan.

The errors outlined above did not affect the total loans receivable reported on the financial statements; however, when NIS is not reconciled to internal loans receivable records, there is an increased risk that errors will not be detected and loan balances will not be accurate. Furthermore, when loan activity is not accurately recorded in NIS, individual loan balances will not be accurate.

We recommend the Department periodically reconcile NIS to the Department's internal Drinking Water loans receivable records at fiscal year end, at the minimum. Furthermore, we recommend all errors noted above be corrected in NIS.

Department's Response: NDEQ Management recognizes the importance of loan reconciliation between NIS and internal Drinking Water loans receivable records, as well as NIS and the Automated Standard Application for Payments (ASAP) system. We have taken measures to establish procedures that accomplish the recommended reconciliations by:

- 1) Reconciling NIS loan information to internal Drinking Water loans receivable records on a monthly basis, adjusting or correcting discrepancies as appropriate, and*
- 2) Reconciling NIS general ledger information to ASAP Drinking Water grant activity on at least a quarterly basis, adjusting or correcting discrepancies as appropriate.*

Errors noted in the audit report for Boyd County, Stamford, and Ceresco have been corrected.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
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COMMENTS AND RECOMMENDATIONS

(Continued)

2. Financial Statement Errors

Sound accounting practice and a good internal control plan require financial information and report disclosures to be complete and accurate. The accounting staff should have an understanding of all entries and supporting documentation for all numbers included on the financial statements. Sound accounting practice further requires correct calculations of data included in the financial information.

Errors were noted on the trial balance prepared by the Department. The trial balance numbers are carried forward to the financial statements. While the largest error was \$30,228, there were numerous errors as outlined in the following list.

<u>Account</u>	<u>Original Amount</u>	<u>Corrected Amount</u>	<u>Change</u>
Bond Interest Payable	\$ 342,824	\$ 348,902	\$ 6,078
Bonds Payable - Short Term	1,240,000	1,255,000	15,000
Bonds Payable - Long Term	14,420,000	14,405,000	(15,000)
Interest Earning - Bond Accounts	347,428	347,525	97
Interest Earnings - State Street	-	15,464	15,464
Loan Interest	2,118,496	2,088,268	(30,228)
Bond Interest Expense	659,160	681,194	22,034
Bond Issue Expense	103,194	79,508	(23,686)
Bond Issue Adjustment	6,938	-	(6,938)

The financial statements were adjusted for the errors noted.

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

We recommend the Department develop procedures to ensure financial information presented is accurate, complete, and documented.

Department's Response: During the period of this audit report, NDEQ experienced a changeover of key financial personnel who were responsible for revolving fund transactions and reporting. New personnel took over these duties with minimal cross training, and were required to find documentation for transactions they had not previously been responsible for under tight timeframes.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
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COMMENTS AND RECOMMENDATIONS
(Continued)

2. Financial Statement Errors (Concluded)

Department's Response, Continued:

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



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NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY DRINKING WATER STATE REVOLVING FUND PROGRAM

INDEPENDENT AUDITORS' REPORT

Nebraska Department of Environmental Quality
Lincoln, Nebraska

We have audited the accompanying financial statements of the business type activities of the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program (Program), as of and for the year ended June 30, 2009, which collectively comprise the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's basic financial statements as listed in the Table of Contents. These basic financial statements are the responsibility of the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements of the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program, are intended to present the financial position and changes in financial position of only that portion of the business type activities of the State that is attributable to the transactions of the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program. They do not purport to, and do not, present fairly the financial position of the business type activities of the State of Nebraska as of June 30, 2009, and its changes in financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business type activities of the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program, as of June 30, 2009, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 24, 2010, on our consideration of the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

In accordance with the *U.S. Environmental Protection Agency Audit Guide for Clean Water and Drinking Water State Revolving Fund Programs*, we have also issued our report dated May 24, 2010 on our consideration of the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's compliance with certain provisions of laws, regulations, and grants.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's basic financial statements. Management's Discussion and Analysis is presented for purposes of additional analysis and is not a required part of the basic financial statements. Management's Discussion and Analysis has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on it.

Signed Original on File

May 24, 2010

Timothy J. Channer, CPA
Assistant Deputy Auditor

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

This section of the Nebraska Department of Environmental Quality - 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, 2009. This analysis has been prepared by management of the Department, and is intended to be read in conjunction with the Program's financial statements and related footnotes that follow this section.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the Program's basic financial statements. The Program's basic financial statements include: 1) Balance Sheet, 2) Statement of Revenues, Expenses, and Changes in Net Assets, 3) Statement of Cash Flows, and 4) Notes to the Financial Statements.

The Balance Sheet presents information on all of the Program's assets and liabilities, with the difference between the two reported as net assets. The Statement of Revenues, Expenses, and Changes in Net Assets presents information showing how the Program's net assets changed during the most recent fiscal year.

The Statement of Cash Flows presents the Program's flows of cash by defined categories. The primary purpose of the Statement of Cash Flows is to provide information about the Program's cash receipts and payments during the year.

The Notes to the Financial Statements are an integral part of the financial statements and provide information that is essential to a full understanding of the data provided in the financial statements.

ANALYSIS OF BALANCES AND TRANSACTIONS OF ENTERPRISE FUND

Changes in Net Assets

For the fiscal year ended June 30, 2009, net assets of the Program increased by 8%. Revenues for the Program increased 3% while expenses decreased 9%.

NET ASSETS			
	<u>2009</u>	<u>2008</u>	<u>% Change</u>
Current Assets	\$ 44,102,743	\$ 31,269,630	41%
Noncurrent Assets	63,068,337	68,459,816	(8%)
Total Assets	<u>107,171,080</u>	<u>99,729,446</u>	<u>7%</u>
Current Liabilities	1,603,902	1,418,124	13%
Noncurrent Liabilities	14,405,000	13,695,000	5%
Total Liabilities	<u>16,008,902</u>	<u>15,113,124</u>	<u>6%</u>
Net Assets:			
Restricted	1,968,875	1,773,635	11%
Unrestricted	89,193,303	82,842,687	8%
Total Net Assets	<u>\$ 91,162,178</u>	<u>\$ 84,616,322</u>	<u>8%</u>

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

MANAGEMENT'S DISCUSSION AND ANALYSIS UNAUDITED)

(Continued)

	2009	2008	% Change
Loan Fees Administration	\$ 716,611	\$ 725,174	(1%)
Interest	3,356,248	3,226,677	4%
Total Operating Revenues	4,072,859	3,951,851	3%
Administration	1,770,039	2,043,570	(13%)
Bond Expenses	681,194	641,068	6%
Total Operating Expenses	2,451,233	2,684,638	(9%)
Operating Income	1,621,626	1,267,213	28%
Capital Federal Grants	4,924,230	7,108,263	(31%)
Change in Net Assets	6,545,856	8,375,476	(22%)
Net Assets, Beginning of Year	84,616,322	76,240,846	11%
Net Assets, End of Year	\$91,162,178	\$ 84,616,322	8%

The most significant changes from the fiscal year ended June 30, 2008, to the fiscal year ended June 30, 2009, were the Current Assets balance and the amount received from Capital Federal Grants. A transfer of approximately \$3.2 million from a long-term investment to the Operating Investment Pool (OIP) accounts for a portion of the increase in Current Assets. The capitalization grants received from the EPA decreased significantly in fiscal year 2009 after an increase the past few years. Federal funds will vary each year depending on the size of each draw, the timing of each draw, the number of communities applying for loans, and the number of loans successfully processed. Changes are inherent in the Drinking Water program and are expected when draws are based on community requests. The need to draw down Capital Federal Grant money decreased in fiscal year 2009.

ECONOMIC OUTLOOK

Nebraska's economy has been affected by the current national economic decline and Nebraska's economy has and will likely continue to impact the future net revenues of the State. Tax revenues continue to fall short of projections. How the Program's revenue will be affected by the current national economy decline and market freefall is unknown. The Program is included in the American Recovery and Reinvestment Act of 2009 (ARRA) and is expected to receive approximately \$19.5 million in additional funding in fiscal year 2010. The ARRA funding does not require a State match.

DEBT ADMINISTRATION

Long-Term Debt

The Drinking Water State Revolving Fund had long-term debt activity during the fiscal year as shown above in the line titled Noncurrent Liabilities in the Net Assets section. See the Notes to the Financial Statements for more detailed information on the Bonds Payable, which represents the Fund's long-term debt activity for the year.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM
BALANCE SHEET
June 30, 2009

	<u>Enterprise Fund</u>
ASSETS	
CURRENT ASSETS	
Cash and Cash Equivalents:	
Cash in State Treasury (Note 2)	\$ 26,018,465
Amounts Held by Trustee (Note 2)	11,060,605
Interest Receivable	79,015
Loans Receivable (Note 3)	6,944,658
TOTAL CURRENT ASSETS	<u>44,102,743</u>
NON-CURRENT ASSETS	
Loans Receivable (Note 3)	63,068,337
TOTAL NON-CURRENT ASSETS	<u>63,068,337</u>
TOTAL ASSETS	<u><u>\$ 107,171,080</u></u>
LIABILITIES	
CURRENT LIABILITIES	
Accrued Bond Interest Payable	\$ 348,902
Bonds Payable (Note 4)	1,255,000
TOTAL CURRENT LIABILITIES	<u>1,603,902</u>
NON-CURRENT LIABILITIES	
Bonds Payable (Note 4)	14,405,000
TOTAL NON-CURRENT LIABILITIES	<u>14,405,000</u>
TOTAL LIABILITIES	<u>16,008,902</u>
NET ASSETS	
Restricted for Bond Payments	1,968,875
Unrestricted	89,193,303
TOTAL NET ASSETS	<u>91,162,178</u>
TOTAL LIABILITIES AND NET ASSETS	<u><u>\$ 107,171,080</u></u>

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

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
 DRINKING WATER STATE REVOLVING FUND PROGRAM
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
 For the Year Ended June 30, 2009

	<u>Enterprise Fund</u>
OPERATING REVENUES:	
Loan Fees Administration (Note 6)	\$ 716,611
Interest on Loans	2,088,268
Interest on Fund Balance - Trustee	347,525
Interest on Fund Balance - Long-Term Investment (Notes 2 and 7)	15,464
Interest on Fund Balance - State Operating Investment Pool (Note 7)	904,991
TOTAL OPERATING REVENUES	<u>4,072,859</u>
OPERATING EXPENSES:	
Administration (Note 9)	372,047
15% Source Water Assessment Program (Note 9)	544,709
2% Technical Assistance to Small Systems (Note 9)	236,847
10% Public Water Supply System (Note 9)	259,276
30% Loan Forgiveness (Note 9)	256,886
Cost of Bond Issuance	79,508
Bond Issue Discount	20,766
Interest Expense - State Match Bonds (Note 9)	681,194
TOTAL OPERATING EXPENSES	<u>2,451,233</u>
OPERATING INCOME	1,621,626
CAPITAL CONTRIBUTIONS - FEDERAL GRANTS	<u>4,924,230</u>
CHANGE IN NET ASSETS	6,545,856
TOTAL NET ASSETS, BEGINNING OF YEAR	<u>84,616,322</u>
TOTAL NET ASSETS, END OF YEAR	<u><u>\$ 91,162,178</u></u>

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, 2009

	<u>Enterprise Fund</u>
CASH FLOWS FROM OPERATING ACTIVITIES:	
Receipts From Customers	\$ 9,390,584
Interest on Investments	1,256,462
Payments to Borrowers	(5,199,581)
Bond Issue	1,944,234
Payments to Employers and Vendors	(1,669,766)
Bond Principal Payments	(1,090,000)
Cost of Bond Issuance	(79,508)
Transfer Long-Term Investment to Cash	2,664,043
Bond Interest Payments	(660,416)
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>6,556,052</u>
CASH FLOWS FROM NON-CAPITAL & RELATED FINANCING ACTIVITIES:	
Funds Received From the Environmental Protection Agency	<u>4,924,330</u>
NET CASH FROM NON-CAPITAL & RELATED FINANCING ACTIVITIES	4,924,230
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>25,598,788</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u><u>\$ 37,079,070</u></u>
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES:	
Operating Income	\$ 1,621,626
ADJUSTMENTS TO RECONCILE OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES:	
(Increase)/Decrease in Loans Receivable	1,362,869
(Increase)/Decrease in Interest Receivable	(11,518)
(Increase)/Decrease in Loan Interest Receivable	18,153
(Increase)/Decrease in Admin Fees Receivable	5,101
(Increase)/Decrease in Long-Term Investment	2,664,043
Increase/(Decrease) in Bonds Payable	875,000
Increase/(Decrease) in Accrued Bond Interest Payable	20,778
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u><u>\$ 6,556,052</u></u>

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

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO THE FINANCIAL STATEMENTS

For the Fiscal Year Ended June 30, 2009

1. Summary of Significant Accounting Policies

A. Basis of Presentation

The accompanying basic financial statements of the Nebraska Department of Environmental Quality (Department) - Drinking Water State Revolving Fund Program (Program) have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

The basic financial statements have been prepared primarily from accounts maintained by the State Accounting Administrator of the Department of Administrative Services (DAS) and the Trustee (Wells Fargo Bank, Iowa) for the State match bond accounts.

B. Reporting Entity

The Drinking Water State Revolving Fund Program is a program within the Department and is established under and governed by the Safe Drinking Water Act of the Federal Government and the Drinking Water State Revolving Fund Act of the State of Nebraska. The Department is a State agency established under and governed by the laws of the State of Nebraska. As such, the Department is exempt from State and Federal income taxes. The Program's management has considered all potential component units of the Program for which it is financially accountable, and other organizations which are fiscally dependent on the Program, or the significance of their relationship with the Program are such that exclusion would be misleading or incomplete. GASB has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body, and (1) the ability of the Department to impose its will on that organization, or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on the Department.

As required by generally accepted accounting principles, these financial statements present the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program. No component units were identified. The Program is part of the primary government for the State of Nebraska's reporting entity.

C. Fund Structure

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

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

1. Summary of Significant Accounting Policies (Continued)

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

- Drinking Water Facilities Funds – General Fund 10000, Federal Funds 48416, 48417, and 48418, and Bond Funds 68480, 68481, 68482, 68483, and 68484.
- Drinking Water Administration Fund – Cash Fund 28630.

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

The activity of these State of Nebraska funds have been combined and reported as an enterprise fund, which under governmental GAAP is a proprietary fund type. This fund type reflects transactions used to account for those operations that are financed and operated in a manner similar to a private business. The accounting for the Program's transactions in this manner is a requirement of the Environmental Protection Agency (EPA) as they and the Department have decided that the determination of revenues earned, expenses incurred, and/or net income is necessary to demonstrate the success of the Program and to assure the EPA the Program will be available in perpetuity as intended.

This fund classification differs from the classification used in the State of Nebraska's Comprehensive Annual Financial Report (CAFR). The CAFR classifies the Cash funds, Federal funds, and Bond funds as Special Revenue funds because the major source of revenue is Federal assistance.

D. Measurement Focus, Basis of Accounting

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. An enterprise fund is accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation of the fund are included on the balance sheet. Enterprise fund operating statements present increases (i.e., revenues) and decreases (i.e., expenses) in total net assets.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

1. Summary of Significant Accounting Policies (Continued)

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

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

E. Cash and Cash Equivalents

In addition to bank accounts and petty cash, this classification includes all short-term investments such as certificates of deposit, repurchase agreements, and U.S. treasury bills. These short-term investments may have original maturities (remaining time to maturity at acquisition) greater than three months; however, cash is available and is considered cash and cash equivalents for reporting purposes. These investments are stated at cost, which at June 30, 2009, approximates market. Banks pledge collateral, as required by law, to guarantee State funds held in time and demand deposits.

Cash and Cash Equivalents are under the control of the State Treasurer or other administrative bodies as determined by law. All cash deposited with the State Treasurer is initially maintained in a pooled cash account. On a daily basis, the State Treasurer invests cash not needed for current operations with the State's Investment Council that maintains an operating investment pool for such investments. Interest earned on these investments is allocated to funds based on their percentage of the investment pool.

Amounts Held by Trustee are considered cash equivalents due to their liquid nature.

F. Loans Receivable

The State operates the Program as a direct loan program, whereby loans are made to communities. The entire Drinking Water Program is funded, on average, 83.33% from Federal capitalization grants and 16.67% from State matching funds. Loan funds are disbursed to the local agencies as they expend funds for the purposes of the loan. Interest is calculated from the date the funds are advanced, and after the final disbursement has been made, the payment schedule identified in the loan agreement is adjusted for the actual amounts disbursed and accrued interest during the project period. The interest

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

1. Summary of Significant Accounting Policies (Concluded)

rates on loans range from 2.0% to 4.3% and the terms are between 5 to 20 years. Disadvantaged communities may have up to 30 years to repay. The current loans receivable amount was determined using the amount of principal payment due to the Program at June 30, 2009, which is collectible in fiscal year 2010.

No provisions were made for uncollectible accounts as all loans were current and management believed all loans would be repaid according to the loan terms. There was a provision for the Program to intercept State aid to a community in default of its loan.

G. Accounts Payable

The Nebraska Information System (NIS) has the capability of showing the amount of accounts payable at any time. The amount shown at June 30, 2009, is the figure that was used for this amount.

H. Restricted Net Assets

When both restricted and unrestricted resources are available for use, it is the Department's policy to use restricted resources first, then unrestricted resources, as they are needed. Net Assets are reported as restricted when they are held in a separate account that can be used to pay debt principal and interest only and cannot be used to pay other current liabilities.

I. Use of Estimates

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

2. Cash in State Treasury, Amounts Held by Trustee, Long-Term Investments

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

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

2. **Cash in State Treasury, Amounts Held by Trustee, Long-Term Investments**
(Continued)

investments can be found in the State of Nebraska's CAFR for the fiscal year ended June 30, 2009. All interest revenue is allocated to the general fund except allocations required by law to be made to other funds. All funds of the Drinking Water State Revolving Fund Program were designated for investment during fiscal year 2009. Amounts are allocated on a monthly basis based on average balances of all invested funds.

Amounts Held by Trustee. The Nebraska Investment Finance Authority (NIFA) (the "Issuer") issues revenue bonds, the proceeds which are used by the Department to provide the 20% match requirements for the Department's Federal Capitalization Grants (See Note 4, Bonds Payable, for more details on these bonds). Wells Fargo Bank Iowa, National Association (Trustee), as Trustee, establishes the appropriate accounts and invests the monies in accordance with the Bond Indenture. At June 30, 2009, the amount held by the Trustee of \$11,060,605 was considered cash and cash equivalents and was stated at fair value, except for the amounts invested in GICs, where no readily ascertainable fair value was available. For this investment, the Program manager received an estimate of fair value from the Trustee. The amount held by the Trustee consisted of the following:

	Fair Value
Cash	\$ 165,194
Money Market Account	5,906,259
Guaranteed Investment Contracts (GICs) in CDC Funding Corporation	4,989,152
TOTAL	<u>\$ 11,060,605</u>

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. The deposits held by the Trustee were uninsured and uncollateralized during and at the end of fiscal year 2009. The Program does not have a custodial credit risk policy for deposits.

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:

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

2. **Cash in State Treasury, Amounts Held by Trustee, Long-Term Investments**
(Concluded)

- Credit Risk – Credit risk is a risk that an issuer of debt securities or another counterparty to an investment transaction will not fulfill an obligation and is commonly expressed in terms of the credit quality rating issued by a national rating organization. The GIC fund was unrated by Standard & Poor's Rating Group and Moody's Investors Service Inc.
- Custodial Credit Risk of Investments – Custodial credit risk for investments is the risk that in the event of the failure of a counterparty, the Program will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The GIC fund held by the Trustee was uninsured and held by and in the name of the Trustee, not in the name of the Program.
- Concentration of Credit Risk – When investments are concentrated in one issuer, this concentration represents heightened risk of potential loss. No specific percentage identifies when concentration risk is present. GASB has adopted a principle that governments should provide note disclosure when 5% of the total government investments are concentrated in any one issuer. The Program had 45% of its total investments in the GIC fund.

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

Long-Term Investments. The Department moved their long-term investment of \$3,188,163 to the State's OIP during the fiscal year. The Department has no long-term investments as of June 30, 2009.

3. **Loans Receivable**

As of June 30, 2009, the Program had made loans to 112 communities of which 85 had outstanding balances totaling \$70,012,995. The outstanding balances of the ten communities with the largest loan balances, which represents 64.7% of the total loans, were as follows:

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

3. Loans Receivable (Concluded)

City	Outstanding Balance
Kearney	\$ 9,930,633
McCook	8,335,698
North Platte	7,296,493
Sidney	6,899,917
Blair	4,655,397
Beaver Lake Association	2,832,321
Broken Bow	1,612,586
Plattsmouth	1,462,361
South Sioux City	1,187,671
Cozad	1,072,601
TOTAL	<u>\$ 45,285,678</u>

4. Bonds Payable

The State has entered into a special financing arrangement with NIFA, an independent instrumentality of the State exercising essential public functions, to provide matching funds for the State's Drinking Water Program. NIFA issues the bonds and the proceeds are held by the Trustee until they are needed by the Program for loan purposes. The Series 2000A, 2001A, 2002A, 2003A, 2004A, 2005A, 2006A, 2007A, and 2008A Bonds are limited obligations of NIFA, payable only from and secured only by the Trust Estate. The Series 2000A, 2001A, 2002A, 2003A, 2004A, 2005A, 2006A, 2007A, and 2008A Bonds are revenue bonds. The Series 2000A, 2001A, 2002A, 2003A, 2004A, 2005A, 2006A, 2007A, and 2008A Bonds shall not constitute a debt, liability, general obligation of the State, or a pledge of the faith and credit of the State, but are payable solely out of the revenue or money NIFA pledged to the Trust Estate. Neither the faith and credit nor the taxing power of the State is pledged for the payment of the principal of, premium, if any, or the interest on the Series 2000A, 2001A, 2002A, 2003A, 2004A, 2005A, 2006A, 2007A, and 2008A Bonds. The current bonds payable amount was determined using the amount of bond principal to be retired in fiscal year 2010. Bonds payable for the fiscal year ended June 30, 2009, is as follows:

	Beginning Balance	Additions	Retirement	Ending Balance	Current Portion
Bonds Payable	<u>\$ 14,785,000</u>	<u>\$ 1,965,000</u>	<u>\$ 1,090,000</u>	<u>\$ 15,660,000</u>	<u>\$ 1,255,000</u>

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

4. Bonds Payable (Concluded)

Bonds payable at June 30, 2009, consist of the following:

Series	Original Issue	Retirements	2009 Balance	Interest Rate	Final Maturity Date
2000A	\$ 5,530,000	\$ 2,140,000	\$ 3,390,000	4.8-5.7%	July 1, 2015
2001A	1,815,000	680,000	1,135,000	3.9-5.15%	Jan. 1, 2016
2002A	2,000,000	665,000	1,335,000	1.8-4.6%	Jan. 1, 2017
2003A	1,700,000	490,000	1,210,000	1.3-3.8%	Jan. 1, 2018
2004A	1,890,000	410,000	1,480,000	1.6-4.26%	July 1, 2019
2005A	1,920,000	290,000	1,630,000	2.75-4.2%	July 1, 2020
2006A	1,915,000	215,000	1,700,000	3.6-4.3%	Jan. 1, 2021
2007A	1,920,000	105,000	1,815,000	3.5-4.35%	Jan. 1, 2022
2008A	1,965,000		1,965,000	2.75-5.0%	Jan. 1, 2023

The 2000A Series Bonds were issued June 29, 2000, the 2001A Series Bonds were issued March 28, 2001, the 2002A Series Bonds were issued December 19, 2002, the 2003A Series Bonds were issued June 19, 2003, the 2004A Series Bonds were issued September 16, 2004, the 2005A Series Bonds were issued August 15, 2005, the Series 2006A Bonds were issued June 8, 2006, the Series 2007A Bonds were issued September 28, 2007, and the Series 2008A Bonds were issued October 3, 2008. Bonds mature at various intervals through January 2023. The debt service requirements on bonds maturing in subsequent years are as follows:

Year Ending June 30	Principal	Interest	Total
2010	\$ 1,255,000	\$ 684,980	\$ 1,939,980
2011	1,295,000	634,565	1,929,565
2012	1,360,000	580,084	1,940,084
2013	1,410,000	521,223	1,931,223
2014	1,465,000	458,485	1,923,485
2015-2019	6,845,000	1,198,505	8,043,505
2020-2023	2,030,000	172,686	2,202,686
TOTAL	\$ 15,660,000	\$ 4,250,528	\$ 19,910,528

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

5. Net Assets

Included in the Net Assets is the total amount of capitalization grants drawn from the EPA by the Department. The following summarizes the EPA capitalization grants awarded, drawn, and the remaining balance as of June 30, 2009. The year column relates directly to the grant amount column and represents the year the grant was awarded. The amount drawn column is as of June 30, 2009, and may have been drawn over multiple years.

Year	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	8,283,106	2,394
2006	8,229,300	8,121,220	108,080
2007	8,229,000	6,154,851	2,074,149
2008	8,146,000	312,934	7,833,066
2009	-	-	-
TOTAL	<u>\$ 100,204,726</u>	<u>\$ 90,187,037</u>	<u>\$ 10,017,689</u>

The 2009 grant was delayed and was not awarded until September 10, 2009, after the end of State fiscal year 2009.

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

Contributed Capital July 1, 2008	\$ 87,591,643
Contributed During the Year Funds	
Received From EPA	<u>4,924,230</u>
Contributed Capital June 30, 2009	<u>\$ 92,515,873</u>

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

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

6. Loan Fees Administration

The reported amount comes from a fee charged to loan recipients each year based on the amount of the loan outstanding. The fee is 1% per annum and is collected semi-annually.

7. Interest on Fund Balance – State Operating Investment Pool

The reported amount represents the earnings the Program received from idle funds invested by the Nebraska State Treasurer with the State's Investment Council. Interest is credited on approximately the twenty-fifth day of each subsequent month.

8. Operating Revenues and Expenses

Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the Program's principal ongoing operations. The principal operating revenue of the Program is the Loan Fees Administration. Interest revenues are also operating revenues since making loans is the primary purpose of the Program. The principal operating expenses of the Program are administration expenses and loan forgiveness. Interest expenses are also operating expenses since making loans is the primary purpose of the Program.

9. Operating Expenses

The Operating Expenses of the Drinking Water State Revolving Fund Program are classified, for financial reporting purposes, into seven categories. There are four set-aside activities established under § 1452 of the Safe Drinking Water Act. The four set-aside activities are:

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

All are required to be federally funded. State match dollars can only be used for the purpose of providing loans to owners of Public Water Supply Systems. Other significant categories of expenses are 30% Loan Forgiveness, and Interest Expense-State Match Bonds.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

9. Operating Expenses (Continued)

Following is an explanation of these categories:

15% Source Water Assessment Program

Identified in Federal regulations as local assistance and other state programs, a state may use up to 15% of the capitalization grant amount for specified uses as follows:

- Assistance to a public water system to acquire land or a conservation easement for source water protection purposes;
- Assistance to a community water system to implement voluntary, incentive-based source water quality protection measures;
- Provide funding to delineate and assess source water protection areas;
- To support the establishment and implementation of wellhead protection programs; and
- To provide funding to a Public Water System to implement technical and/or financial assistance under the capacity development strategy.

4% Administration

A state may use up to 4 percent of the funds allotted to it for the reasonable costs of administering the program and providing technical assistance. These costs may include such activities as issuing debt; start up costs; audit costs; financial management; legal consulting fees; development of IUP (Intended Use Plan) and priority ranking system; development of affordability criteria; and costs of support services provided by other state agencies. If the state does not obligate the entire 4 percent for administrative costs in one year, it can bank the excess balance and use it for administrative costs in later years. The Department did not expend any of the administration from Federal funds. The Administration costs were paid from loan fee revenues.

2% Technical Assistance to Small Systems

A state may use up to 2 percent of its allotment to provide technical assistance to public water systems serving 10,000 people or less. If the state does not use the entire 2 percent for these activities against a given allotment, it can bank the excess balance and use it for the same activities in later years. A state may use these funds to support a technical assistance team or to contract with outside organizations to provide technical assistance.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

9. Operating Expenses (Concluded)

10% Public Water Supply System

A state may use up to 10 percent of its allotment to:

- Administer the State Public Water Supply System program;
- Administer or provide technical assistance through source water protection programs, which includes the Class V portion of the Underground Injection Control Program;
- Develop and implement a capacity development strategy; and
- Develop and implement an operator certification program.

30% Loan Forgiveness

The amount of expenses reported as Loan Forgiveness is the amount the State forgave loans to communities meeting the definition “disadvantaged” or, which the State expects to become disadvantaged as a result of the project. The amount of these subsidies during a particular fiscal year’s capitalization grant cannot exceed 30 percent of the amount of the capitalization grant for that year.

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

Interest Expense-State Match Bonds

The amount is interest paid to bond holders at the time bond principal was retired during the fiscal year.

10. State Employees Retirement Plan (Plan)

The single-employer plan became effective by statute on January 1, 1964. The Plan consists of a defined contribution option and a cash balance benefit. The cash balance benefit is a type of defined benefit plan. Each member employed and participating in the retirement system prior to January 1, 2003, elected to either continue participation in the defined contribution option or begin participation in the cash balance benefit. The defined contribution option is closed to new entrants. All new members of the Plan on

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

10. **State Employees Retirement Plan (Plan)** (Continued)

and after January 1, 2003, become members of the cash balance benefit. Additionally, on or after November 1, 2007, but before January 1, 2008, members who were employed and participating in the retirement system could elect to continue participation in the defined contribution option or elect to participate in the cash balance benefit. Members who elected to participate in the cash balance benefit during this timeframe commenced participation in the cash balance benefit on January 1, 2008. The benefits and funding policy of the Plan is established and can only be amended by the Nebraska Legislature.

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

Contribution. Per statute, each member contributes 4.8% of his or her monthly compensation. The Department matches the member's contribution at a rate of 156%. The employee's and employer's contributions are kept in separate accounts.

The employee's account is fully vested. The employer's account is fully vested after a total of three years of participation in the system, including credit for participation in another Nebraska governmental plan prior to actual contribution to the Plan.

Defined Contribution Option. Upon attainment of age 55, regardless of service, the retirement allowance shall be equal to the sum of the employee and employer account. Members have several forms of payment available, including withdrawals, deferrals, annuities, or a combination of these.

Cash Balance Benefit. Upon attainment of age 55, regardless of service, the retirement allowance shall be equal to the accumulated employee and employer cash balance accounts, including interest credits, annuitized for payment in the normal form. The normal form of payment is a single life annuity with five year certain, payable monthly. Members will have the option to convert their member cash balance account to a monthly annuity with built in cost-of-living adjustments of 2.5% annually. Also available are additional forms of payment allowed under the Plan which are actuarially equivalent to the normal form, including the option of lump-sum or partial lump-sum.

For the fiscal year ended June 30, 2009, employees contributed \$9,288 and the Department contributed \$14,489. A separate plan report is issued and can be obtained from the Nebraska Public Employees Retirement System. This report contains full pension-related disclosures.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

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

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

11. Contingencies and Commitments

Risk Management. The Department is exposed to various risks of loss related to torts, theft of, damage to, or destruction of assets, errors or omissions, injuries to employees, and natural disasters. The Department, as part of the primary government for the State, participates in the State's risk management program. DAS is responsible for maintaining the insurance and self-insurance programs for the State. The State generally self-insures for general liability, employee health care, employee indemnification, and Workers' compensation. The State has chosen to purchase insurance for:

- A. Motor vehicle liability, which is insured for the first \$5 million of exposure per accident with a self-insured retention of \$300,000 per accident, except for accidents involving vehicular pursuit which have a \$1,000,000 self-insured retention per accident. Insurance is also purchased for physical damage and uninsured and underinsured motorists with various limits and deductibles. State agencies have the option to purchase coverage for physical damage to vehicles.
- B. Life insurance for eligible employees.
- C. Crime coverage, with a limit of \$31 million for each loss, and a \$25,000 self-insured retention per incident subject to specific conditions, limits, and exclusions.
- D. Real and personal property on a blanket basis for losses up to \$250,000,000, with a self-insured retention of \$200,000 per loss occurrence. Newly acquired properties are covered up to \$5,000,000 for 120 days or until the value of the property is reported to the insurance company. The perils of flood, earthquake, and acts of terrorism have various coverage, sub-limits, and self insurance. State agencies have the option to purchase building contents and inland marine coverage.

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

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO THE FINANCIAL STATEMENTS

(Continued)

11. Contingencies and Commitments (Concluded)

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

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

12. Reconciliation of Bank Records to the State's General Ledger

Through their bank reconciliation procedures, DAS – State Accounting identified a variance between the State Treasurer's bank statements and the State's balances in the general ledger (NIS). The bank records were short as compared to the accounting records. Monthly reconciliations were completed by DAS – State Accounting for July 2005 through May 2009. The variance between the bank records and the balance in NIS was consistent at \$1,065,210 for all the months noted. DAS - State Accounting reduced the total Operating Investment Pool (OIP) interest distributed to each agency in June 2009. The total OIP interest distributed was reduced by \$897,282 which consisted of the net of the \$1,065,210 variance between the bank records and accounting records, and \$167,928 of other miscellaneous adjustments. As of June 30, 2009, there was no variance between the bank records and the accounting records. The effect on the Program's financial statements was not significant.



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NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM
**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON
COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

Nebraska Department of Environmental Quality
Lincoln, Nebraska

We have audited the financial statements of the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program as of and for the year ended June 30, 2009, and have issued our report thereon dated May 24, 2010. The report was modified to emphasize the financial statements present only the funds of the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's financial statements that is more than inconsequential will not be prevented or detected by the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's internal control. We consider the following deficiencies described in the Comments Section of the report to be significant deficiencies in internal control over financial reporting: Comment Number 1 (Loans Receivable Reconciliation) and Comment Number 2 (Financial Statement Errors).

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that none of the significant deficiencies described above is a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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

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

Signed Original on File

May 24, 2010

Timothy J. Channer, CPA
Assistant Deputy Auditor



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**NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM
REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE
WITH REQUIREMENTS APPLICABLE TO THE NEBRASKA DEPARTMENT OF
ENVIRONMENTAL QUALITY - DRINKING WATER STATE REVOLVING
FUND PROGRAM IN ACCORDANCE WITH THE U.S. ENVIRONMENTAL
PROTECTION AGENCY AUDIT GUIDE FOR CLEAN WATER AND
DRINKING WATER STATE REVOLVING FUND PROGRAMS**

Nebraska Department of Environmental Quality
Lincoln, Nebraska

We have audited the compliance of the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program with the types of compliance requirements described in the *U.S. Environmental Protection Agency Audit Guide for Clean Water and Drinking Water State Revolving Fund Programs* that were applicable for the year ended June 30, 2009. We audited the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's compliance with requirements governing: Allowability for Specific Activities, Allowable Costs/Cost Principles, Cash Management, State Matching, Period of Availability of Funds and Binding Commitments, Program Income, Reporting, Subrecipient Monitoring, and Special Tests and Provisions. Compliance with these requirements is the responsibility of the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's management. Our responsibility is to express an opinion on the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's compliance based on our audit.

Compliance

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

In our opinion, the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program complied, in all material respects, with the requirements referred to above that are applicable to the Program for the fiscal year ended June 30, 2009.

Internal Control Over Compliance

The management of the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants. In planning and performing our audit, we considered the Nebraska Department of Environmental Quality - Drinking Water State Revolving Fund Program's internal control over compliance with requirements that could have a direct and material effect on the Program in order to determine our auditing procedures for the purpose of expressing an opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over compliance.

A *control deficiency* in an entity's internal control over compliance 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 noncompliance with a type of compliance requirement of a Federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a Federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a Federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a Federal program will not be prevented or detected by the entity's internal control.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

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

Signed Original on File

May 24, 2010

Timothy J. Channer CPA
Assistant Deputy Auditor