

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

JULY 1, 2013 THROUGH JUNE 30, 2014

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Issued on April 21, 2015

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

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NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

BACKGROUND

The Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program (Program) was established pursuant to the Federal Safe Drinking Water Act of 1996. The Drinking Water State Revolving Fund Act is set out at Neb. Rev. Stat. §§ 71-5314 to 71-5327 (Reissue 2009, Cum. Supp. 2014). 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 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, 2014, the EPA had awarded \$148.5 million in capitalization grants to the State, plus \$19.5 million in American Recovery and Reinvestment Act (ARRA) funds. The award of this \$148.5 million required the State to contribute approximately \$29.7 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 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 and the Program's Intended Use Plan. The Nebraska Department of Health and Human Services – Division of Public Health sets the funding priorities.

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EXIT CONFERENCE

An exit conference was held March 31, 2015, with the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program (Program) to discuss the results of our examination. Those in attendance for the Program were:

<u>NAME</u>	<u>AGENCY</u>	<u>TITLE</u>
Martie Guthrie	DEQ	Budget Officer
Mary Sue Semerena	DHHS	Environmental Health Administrator II
Chin Chew	DHHS	Environmental Engineer Section Supervisor
Kris Young	DEQ	Accountant III
Dawn Martin	DEQ	State Revolving Fund (SRF) Assistant Coordinator
Marty Link	DEQ	Environmental Quality Associate Program Director – Water Quality Division
Kevin Stoner	DEQ	State Revolving Fund (SRF) Supervisor
Dennis Burling	DEQ	Information Technology (IT) Manager
Mary Brady	DEQ	State Revolving Fund (SRF) – Federal Aid Administrator II
Pat Rice	DEQ	Assistant Director
John R. Danforth	DEQ	Environmental Assistant Coordinator
Jim Macy	DEQ	Director
Tom Lamberson	DEQ	Deputy Director
Felix Davidson	Governor’s Office	Chief Operating Officer
Jim Novotny	DEQ	Accountant III
Steve McNulty	DHHS	Environmental Engineer II
Garet Buller	DHHS	Internal Audit Administrator
Curtis Youngman	DAS	State Accounting
Mark Herman	DEQ	Federal Aid Administrator II

Agencies

DAS – Department of Administrative Services

DEQ – Department of Environmental Quality

DHHS – Department of Health and Human Services

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
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SUMMARY OF COMMENT

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

1. ***Technical and Managerial Capabilities:*** Documentation was not adequate to determine that the Technical and Managerial Capabilities were appropriately assessed.

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

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

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

COMMENT AND RECOMMENDATION

1. **Technical and Managerial Capabilities**

The Nebraska Department of Environmental Quality (NDEQ) operates a direct loan program, whereby loans are made to communities as owners of public drinking water systems. Loan funds are disbursed to the local communities as they expend funds for the purposes of the loan. The Program loans are funded from Federal capitalization grants, State match funding, and the Drinking Water State Revolving Fund (DWSRF). The grants are funded, on average, 83.33% from Federal funds and 16.67% from State match funds. An agreement between NDEQ and the Nebraska Department of Health and Human Services (NDHHS), effective October 30, 1997, as amended April 22, 1999, defined the authority of the two agencies in administering the program. Through this agreement, NDEQ and NDHHS jointly administer certain provisions of the Drinking Water Revolving Fund Act.

Neb. Rev. Stat. § 71-5324 (Reissue 2009) provides, in part:

(1) All loans made under the Drinking Water State Revolving Fund Act shall be made only to owners of public water systems that:

(a) Meet the requirements of financial, technical, and managerial capability set by the department;

40 CFR § 35.3520(c) (July 1, 2013) states, in part:

In addition to costs needed for the project itself, the following project-related costs are eligible for assistance from the Fund . . . (3) Costs for restructuring systems that are in significant noncompliance with any national primary drinking water regulation or variance or that lack the technical, financial, and managerial capability to ensure compliance with the requirements of the Act, unless the systems are ineligible under paragraph (d)(2) or (d)(3) of this section.

40 CFR § 35.3520(d) adds the following:

Assistance from the Fund may not be provided to . . . (2) Systems that lack the technical, financial, and managerial capability to ensure compliance with the requirements of the Act, unless the assistance will ensure compliance and the owners or operators of the systems agree to undertake feasible and appropriate changes in operations to ensure compliance over the long-term. (3) Systems that are in significant noncompliance with any national primary drinking water regulation or variance, unless: (i) The purpose of the assistance is to address the cause of the significant noncompliance and will ensure that the systems return to compliance; or (ii) The purpose of the assistance is unrelated to the cause of the significant noncompliance and the systems are on enforcement schedules (for maximum contaminant level and treatment technique violations) or have compliance plans (for monitoring and reporting violations) to return to compliance.

Nebraska Health and Human Services Regulation and Licensure Nebraska Administrative Code (NAC) Title 179-Public Water Systems – Chapter 22 – Operation and Maintenance of Community and Nontransient Non-Community Public Water Systems, Section 22-001 states, in relevant part:

These regulations establish minimum requirements for the operation and maintenance of existing community and non-transient non-community (NTNC) public water systems. The authority is found in Neb. Rev. Stat. §§ 71-5301 to 71-5313.

A good internal control plan requires the assessment of the technical and managerial capabilities of communities receiving DWSRF project funds be adequately documented.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
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COMMENT AND RECOMMENDATION
(Continued)

1. Technical and Managerial Capabilities (Continued)

During testing of three DWSRF loan files, we noted there was inadequate documentation in the loan files to determine whether or not the technical and managerial capabilities of communities were appropriately assessed. In addition, NDEQ and NDHHS did not have documented policies/criteria to measure the assessment of the technical and managerial capabilities of a community.

Based on discussion with NDEQ and NDHHS, it was noted the communities' technical and managerial capabilities are documented through Routine Sanitary Surveys (RSS) and Assessments in accordance with Title 179 NAC 22. Those sanitary surveys of community public water systems are conducted on a three-year basis by NDHHS. They are done for all community public water systems, and the rotating review is tracked in NDHHS' Safe Drinking Water Information System (SDWIS) database.

In addition, NDHHS noted an assessment of the technical and managerial capabilities of a community is not required prior to agreement of a loan, because ensuring those capabilities is a process rather than singular event that is documented. NDHHS also noted that 40 CFR § 35.3520(d)(2) requires a determination of technical and managerial capability to ensure compliance "unless the assistance will ensure compliance and the owners or operators of the systems agree to undertake feasible and appropriate changes in operations to ensure compliance over the long-term." This language is included in the loan agreements between NDEQ and the municipalities. NDHHS believes the language presented in the covenant, in conjunction with the NDHHS RSS and Assessment process, provides proper documentation that the requirements of 40 CFR Section 35.3520 and § 71-5324 have been met.

The Auditor of Public Accounts (APA) believes the process, as explained above, does provide some evidence that NDHHS is assessing the technical and managerial capabilities in compliance with 40 CFR Section 35.3520 and § 71-5324; however, there was little documentation in the loan files, for those loans tested that brought this overall process together, to document clearly that the communities' technical and managerial capabilities were assessed with regard to the loan being made prior to the approval of the Drinking Water Loan for the community project.

When there are not clearly developed policies/criteria to assess the technical and managerial capabilities of communities for loan eligibility, and that assessment is not well documented, there is a greater risk that the technical and managerial capabilities of communities will not be appropriately assessed prior to the approval of the loan agreement.

We recommend NDEQ and NDHHS develop policies/criteria to assess the technical and managerial capabilities of communities and document that assessment within the DWSRF loan files before a loan is finalized.

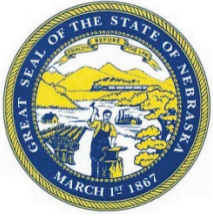
NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
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COMMENT AND RECOMMENDATION
(Concluded)

1. Technical and Managerial Capabilities (Concluded)

Management's Response: The U.S. Environmental Protection Agency has provided written notification that Nebraska's DWSRF is in compliance with the Technical, Financial and Managerial (TFM) requirements of 40 CFR § 35.3520 (c) and (d). Thus the requirements of Neb. Rev. Stat. §71-5324 have also been met, as the requirements established through the DHHS Capacity Development stakeholder process are the same as noted in the CFR.

DHHS will copy the results of the most recent Routine Sanitary Survey into future loan files at the time of, and thus the TFM capabilities referenced therein during, the drafting of the environmental project clearance. Copying the survey results will be done to document the likely start of the TFM capability assessment process prior to a loan closing. Section (d)(2) of the noted CFR allows the program to rely upon the existing DWSRF Capacity Development loan covenant to require that all loan recipients with populations of 10,000 or less complete an Initial, and if necessary, a Final TFM Assessment by the DHHS. That assessment process will continue to ensure that TFM capabilities of Public Water Systems meet the requirements of the Safe Drinking Water Act. Assessment(s) will also be uploaded to the project file. Lastly, the assessment form has been modified to provide documentation they have been reviewed and approved by the DHHS Capacity Development Coordinator and Field Services Program Manager, respectively, for the above noted requirements.



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NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY DRINKING WATER STATE REVOLVING FUND PROGRAM

INDEPENDENT AUDITOR'S REPORT

Nebraska Department of Environmental Quality
Lincoln, Nebraska

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program, as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor

considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective balance sheet of the business-type activities of the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program, as of June 30, 2014, and the respective changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1, the financial statements of the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program are intended to present the balance sheet, the changes in financial position, and cash flows of only that portion of the business-type activities of the State that is attributable to the transactions of the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program. They do not purport to, and do not, present fairly the balance sheet of the Nebraska Department of Environmental Quality as of June 30, 2014, the changes in its financial position, or its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 10 through 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 April 10, 2015, on our consideration of the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program’s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program's internal control over financial reporting and compliance.

Regulatory Requirements

In accordance with the *June 30, 2013 Compliance Supplement—U.S. Environmental Protection Agency Part IV as it pertains to Capitalization Grants for Drinking Water State Revolving Fund Programs*, we have also issued our report dated April 10, 2015, 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.

Lincoln, Nebraska
April 10, 2015



Don Dunlap, CPA
Assistant Deputy Auditor

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

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, 2014. This analysis has been prepared by management of the Agency and is intended to be read in conjunction with the Program’s financial statements and related footnotes, which follow this section.

OVERVIEW OF THE FINANCIAL STATEMENTS

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

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

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

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

ANALYSIS OF BALANCES AND TRANSACTIONS OF ENTERPRISE FUND

Changes in Net Position

For the fiscal year ended June 30, 2014, the net position of the Program increased by 7.4%. Operating revenues for the Program decreased by 0.3%, while operating expenses increased by 11.4%.

NET POSITION

	2014	2013 (As Restated)	% Change
Current Assets	\$ 65,699,956	\$ 60,155,334	9.2%
Noncurrent Assets	89,104,973	85,238,213	4.5%
Total Assets	154,804,929	145,393,547	6.5%
Current Liabilities	1,375,754	1,367,728	.6%
Noncurrent Liabilities	4,804,257	5,584,055	-14.0%
Total Liabilities	6,180,011	6,951,783	-11.1%
Net Position:			
Net Investments in Capital Assets	21,148	-	100%
Restricted	1,019,143	1,019,143	0%
Unrestricted	147,584,627	137,422,621	7.4%
Total Net Position	\$ 148,624,918	\$ 138,441,764	7.4%

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
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MANAGEMENT'S DISCUSSION AND ANALYSIS

(Continued)

CHANGES IN NET POSITION

	2014	2013 (As Restated)	% Change
Loan Fees Administration	\$974,841	\$927,572	5.1%
Interest	3,696,570	3,757,905	-1.6%
Fines, Forfeits & Penalties	-	-	
Total Operating Revenues	4,671,411	4,685,477	-0.3%
Administration & Set-Asides	2,618,967	2,279,006	14.9%
Loan Forgiveness	1,570,078	1,483,094	5.9%
Total Operating Expenses	4,189,045	3,762,100	11.4%
Operating Income (Loss)	482,366	923,377	-47.8%
Capital Contributions Federal Grants	9,983,986	9,711,494	2.8%
Capital Contributions ARRA Grants	-	346,857	-100.0%
Interest Expenses on Bonds	(283,198)	(319,711)	-11.4%
Net Nonoperating Revenue (Expense)	9,700,788	9,738,640	-.4%
Change in Net Position	10,183,154	10,662,017	-4.5%
Beginning Net Position July 1	138,441,764	127,779,747	8.3%
Ending Net Position June 30	148,624,918	\$138,441,764	7.4%

The most significant changes from the fiscal year ended June 30, 2013, to the fiscal year ended June 30, 2014, were the Administration and Set-Asides and Loan Forgiveness balances. Administrative and Set-Aside expenses increased from last fiscal year, particularly in the 10% Public Water Supply System set-a-side. This is a set-a-side utilized by the Department of Health and Human Services for administration of the State Public Water System Supervision program. Funds are utilized from various sources for this purpose. One source may be more fully utilized in one fiscal year over another. Loan Forgiveness also increased, which was a result of the types and make-up of loans paid out during the year. Forgiveness dollars were awarded per grant requirements but were not necessarily paid out on an annual basis. Due to several bond redemptions in previous years, as well as early loan pay-offs in previous and current years, the cash balance has increased significantly. This has resulted in a higher ending Net Position for the program.

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MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

Federal funds will vary each year depending on the size of each draw, the timing of each draw, the number of communities applying for loans, and the number of loans successfully processed. Changes are inherent in the Program and are expected when draws are based on community requests.

ARRA Grant funds were finalized and drawn in full during fiscal year 2013. Therefore, there was no ARRA-specific activity that occurred during fiscal year 2014.

ECONOMIC OUTLOOK

Nebraska's economy has been affected by the current national economic decline in recent years; however, net State General Fund revenue collections have been above projections. The State has continued to take steps to avert major economic impacts both statewide and within communities. The small rural makeup of the State remains a challenge for communities in funding major capital projects. Declining population bases make it difficult to draw the amount of user fees needed to fund infrastructure requirements. As of the fiscal year ended June 30, 2014, the Program had received \$19,500,000 in ARRA grant funds. Approximately half of those funds were provided as principal forgiveness to communities. The ARRA funding did not require a State match. The ARRA grant has been fully utilized and closed by the end of fiscal year 2014.

DEBT ADMINISTRATION

Long-Term Debt

The Drinking Water State Revolving Fund had long-term debt activity during the fiscal year included above in the line titled Noncurrent Liabilities in the Net Position section. See the Notes to the Financial Statements for more detailed information on the Bonds Payable, which represents the fund's long-term debt activity for the year, as well as the fund's short-term debt activity that is new for this 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 tracking 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.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Concluded)

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 providing 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. Beginning in fiscal year 2015, the system will be used concurrently with existing systems to create a basis for reliability and consistency. Once dependable, reconciled results have been 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 Federal EPA procurement. Therefore, expenditures are withheld as an "in-kind" deduction to the total annual DWSRF grant, awarded to the program each year. Federal EPA staff negotiate, monitor, and manage the Northbridge contract for LGTS.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM
BALANCE SHEET
JUNE 30, 2014

	<u>Enterprise Fund</u>
ASSETS	
CURRENT ASSETS:	
Cash and Cash Equivalents:	
Cash in State Treasury (Note 2)	\$ 48,153,803
Amounts Held by Trustee (Note 2)	2,965,883
Amounts Held by Trustee - Restricted (Note 2)	500,121
Investments:	
Amounts Held by Trustee (Note 2)	6,494,846
Amounts Held by Trustee - Restricted (Note 2)	536,935
Due from Contractor	42,720
Due from Federal Government	462,331
Interest Receivable	83,253
Loans Receivable (Note 3)	6,460,064
TOTAL CURRENT ASSETS	65,699,956
NON-CURRENT ASSETS:	
Loans Receivable (Note 3)	89,083,825
Capital Assets, Net (Note 4)	21,148
TOTAL NON-CURRENT ASSETS	89,104,973
TOTAL ASSETS	\$ 154,804,929
 LIABILITIES	
CURRENT LIABILITIES:	
Accounts Payable & Accrued Liabilities	\$ 72,158
Due to Grant Recipients (Note 1)	404,866
Compensated Absences (Note 6)	1,449
Accrued Bond Interest Payable	117,281
Bonds Payable (Note 5)	780,000
TOTAL CURRENT LIABILITIES	1,375,754
NON-CURRENT LIABILITIES:	
Compensated Absences (Note 6)	19,257
Bonds Payable (Note 5)	4,785,000
TOTAL NON-CURRENT LIABILITIES	4,804,257
TOTAL LIABILITIES	6,180,011
 NET POSITION	
Net Investment in Capital Assets	21,148
Restricted - Expendable for Bond Payments	1,019,143
Unrestricted	147,584,627
TOTAL NET POSITION	148,624,918
TOTAL LIABILITIES AND NET POSITION	\$ 154,804,929

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, 2014

	<u>Enterprise Fund</u>
OPERATING REVENUES:	
Loan Fees Administration (Note 8)	\$ 974,841
Interest on Loans	2,350,321
Interest on Fund Balance - Trustee	482,696
Interest on Fund Balance - State Operating Investment Pool (Note 9)	863,553
TOTAL OPERATING REVENUES	4,671,411
OPERATING EXPENSES:	
Administrative Costs from Fees (Note 10)	428,273
15% Source Water Assessment Program (Note 10)	668,084
2% Technical Assistance to Small Systems (Note 10)	142,173
10% Public Water Supply System (Note 10)	1,380,437
Loan Forgiveness (Note 10)	1,570,078
TOTAL OPERATING EXPENSES	4,189,045
OPERATING INCOME	482,366
NONOPERATING REVENUE (EXPENSE)	
Capital Contributions - Federal Grants (Note 7)	9,969,280
Capital Contributions - Federal Grants - Capital Assets	14,706
Interest Expense - State Match Bonds	(236,906)
Interest Expense on Bonds Payable	(9,096)
Cost of Bond Issuance	(37,196)
NET NONOPERATING REVENUE (EXPENSE)	9,700,788
CHANGE IN NET POSITION	10,183,154
TOTAL NET POSITION, BEGINNING OF YEAR - As restated (Note 13)	138,441,764
TOTAL NET POSITION, END OF YEAR	\$ 148,624,918

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, 2014

	Enterprise Fund
CASH FLOWS FROM OPERATING ACTIVITIES:	
Receipts From Customers	\$ 13,659,769
Interest on Investments	1,332,511
Payments to Borrowers	(12,016,791)
Payments for Administration	(423,430)
Payments for 15% Source Water Assessment Program	(682,193)
Payments for 2% Technical Assistance to Small Systems	(126,846)
Payments for 10% Public Water Supply System	(1,618,936)
Payments for Loan Forgiveness	(1,386,843)
NET CASH USED BY OPERATING ACTIVITIES	(1,262,759)
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:	
Funds Received From the Environmental Protection Agency	9,953,279
Receipts from Bond Issue	1,685,000
Bond Principal Payments	(2,435,000)
Bond Interest Payments	(261,291)
Payment for Bond Issuance Costs	(37,196)
NET CASH FROM NON-CAPITAL FINANCING ACTIVITIES	8,904,792
CASH FLOWS FROM INVESTING ACTIVITIES:	
Proceeds from Sales	1,620,055
Purchase of Investments	(1,089,186)
NET CASH FROM INVESTING ACTIVITIES	530,869
CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES:	
Capital Contributions	14,706
Purchase of Capital Assets	(21,148)
NET CASH USED BY CAPITAL FINANCING ACTIVITIES	(6,442)
Increase in Cash and Cash Equivalents	8,166,460
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR - As restated (Note 13)	43,453,347
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 51,619,807
RECONCILIATION OF OPERATING INCOME	
TO NET CASH USED BY OPERATING ACTIVITIES:	
Operating Income	\$ 482,366
ADJUSTMENTS TO RECONCILE OPERATING INCOME	
TO NET CASH USED BY OPERATING ACTIVITIES:	
(Increase)/Decrease in Loans Receivable	(1,682,184)
(Increase)/Decrease in Interest Receivable	(13,737)
(Increase)/Decrease in Due from Contractor	(42,720)
Increase/(Decrease) in Accounts Payable & Accrued Liabilities	(189,936)
Increase/(Decrease) in Compensated Absences	217
Increase/(Decrease) in Due to Grant Recipients	183,235
NET CASH USED BY OPERATING ACTIVITIES	\$ (1,262,759)

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, 2014

1. Summary of Significant Accounting Policies

A. Basis of Presentation

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

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

B. Reporting Entity

The Program is established under and governed by the Safe Drinking Water Act of the Federal Government and the Drinking Water State Revolving Fund Act of the State of Nebraska. The Agency is a State agency established under and governed by the laws of the State of Nebraska. As such, the Agency is exempt from State and Federal income taxes. The Program's management has also considered all potential component units for which it is financially accountable and other organizations that are fiscally dependent on the Program or whose relationship with the Program is so significant that exclusion would be misleading or incomplete. The Governmental Accounting Standards Board (GASB) has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body, and (1) the ability of the Agency to impose its will on that organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the Agency. The Agency is also considered financially accountable if an organization is fiscally dependent on, and there is potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the Agency, regardless of whether the organization has (1) a separately elected governing board, (2) a governing board appointed by a higher level of government, or (3) a jointly appointed board.

These financial statements present the Nebraska Department of Environment Quality – Drinking Water State Revolving Fund Program. No component units were identified. The Program is part of the primary government for the State of Nebraska's reporting entity.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

1. Summary of Significant Accounting Policies (Continued)

C. Fund Structure

The Program's accounts are maintained in accordance with the principles of fund accounting to ensure compliance with limitations and restrictions placed on the use of resources available to it. Under fund accounting, individual funds are established for the purpose of carrying on activities or attaining objectives in accordance with specific regulations, restrictions, or limitations. Each individual fund is a self-balancing set of accounts recording cash and other financial resources, together with liabilities and residual equities or balances, and changes therein. The State accounting system includes the following Program funds, as identified in the Drinking Water State Revolving Fund Act:

- Drinking Water Facilities Funds – General Fund 10000; Federal Funds 48416, 48417, and 48418; and Bond Funds 68480, 68481, 68482, 68483, 68484, 68485, and 68486.
- Drinking Water Administration Fund – Cash Fund 28630

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.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO THE FINANCIAL STATEMENTS

(Continued)

1. Summary of Significant Accounting Policies (Continued)

D. Measurement Focus, Basis of Accounting

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

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

E. Cash and Cash Equivalents and Bond Trustee Investments

Cash and Cash Equivalents – Cash and cash equivalents primarily 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 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, 2014, approximates market. Banks pledge collateral, as required by law, to guarantee State funds held in time and demand deposits.

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

Money Market Funds held by Bond Trustee are also considered cash equivalents due to their liquid nature.

Bond Trustee Investments – The investments held by the Bond Trustee consists of CDC Funding Corporation Guaranteed Investment Contracts (GICs) and are recorded at carrying value.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

1. Summary of Significant Accounting Policies (Continued)

F. Loans Receivable

The State operates the Program as a direct loan program, whereby loans are made to communities. Loan funds are disbursed to the local agencies as they expend funds for the purposes of the loan. Interest is calculated from the date the funds are advanced. After the final disbursement has been made, the amortization schedule identified in the loan agreement is adjusted for the actual amounts disbursed and for accrued interest during the project period. The interest rates on loans range from 2.0% to 4.0%, and the terms could be 5 to 20 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, 2014, which is collectible in fiscal year 2015. Loans receivable that were paid in full, prior to their due date, as of August 31, 2014, were included in the current loans receivable balance as opposed to the long-term loans receivable balance.

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

G. Restricted Net Position

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

H. Use of Estimates

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

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

1. Summary of Significant Accounting Policies (Continued)

I. Compensated Absences

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

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

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

J. Due to Grant Recipients

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

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

1. Summary of Significant Accounting Policies (Continued)

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

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

K. Operating Revenues and Expenses

Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the Program's principal ongoing operations. The primary operating revenues of the Program are the loan fees administration and interest on loans, since making loans is the primary purpose of the Program. The principal operating expenses of the Program are administration expenses and loan forgiveness.

L. Capital Assets

The Drinking Water SRF 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, 2016. The LGTS software is considered an Intangible Capital Asset, and the Agency follows the capitalization policy set forth by the State of Nebraska for Intangible Capital Assets, which requires capitalization of such assets when the cost of such asset is in excess of

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

1. Summary of Significant Accounting Policies (Concluded)

\$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 development 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 and Amounts Held by Bond Trustee

Cash in State Treasury. The Cash in State Treasury, as reported on the balance sheet, is under the control of the Nebraska State Treasurer or other administrative bodies, as determined by law. Investment of all available cash is made by the State Investment Officer on a daily basis, based on total bank balances. These funds are held in the State of Nebraska Operating Investment Pool (OIP), an internal investment pool. Additional information on the deposits and investments portfolio, including investment policies, risks, and types of investments, can be found in the State of Nebraska’s CAFR for the fiscal year ended June 30, 2014. 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 2014. Amounts are allocated on a monthly basis based on average balances of all invested funds.

Amounts Held by Bond Trustee. The Nebraska Investment Finance Authority (NIFA) (the “Issuer”) issues revenue bonds, the proceeds of which are used by the Agency to provide the 20% match requirements for the Agency’s Federal Capitalization Grants (See Note 5, Bonds Payable, for more details on these bonds). Wells Fargo Bank, N.A. (Trustee), as Trustee, establishes the appropriate accounts and invests the monies in accordance with the Master Trust Indenture dated June 1, 2000. At June 30, 2014, the amount held by the Trustee was \$10,497,785. The amount invested in Money Market Funds of \$3,466,004 was considered cash and cash equivalents and was stated at fair value. The amount invested in Guaranteed Investment Contracts (GICs) in the amount of \$7,031,781 are recorded at carrying value. The amount held by the Trustee consisted of the following:

	Fair Value
Money Market Fund	\$ 2,965,883
Money Market Fund (Restricted)	500,121
GICs in CDC Funding Corp.	6,494,846
GICs in CDC Funding Corp.(Restricted)	536,935
TOTAL	\$ 10,497,785

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

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

The amounts shown as money market Funds above are deposits, as defined by GASB. As such, those deposits have custodial credit risk. Custodial credit risk is the risk that, in the event of a bank failure, the Program's deposits may be lost. Of the \$3,466,004 in deposits held by the Trustee, all were uninsured and uncollateralized at the end of the fiscal year ended June 30, 2014, and in varying amounts during the year and, thus, exposed to custodial credit risk. The Program does not have a custodial credit risk policy for deposits.

The Program monies identified in this section are held and invested by the Trustee in its capacity as trustee for the bonds, as specified in the Master Trust Indenture, Section 1.01, dated as of June 1, 2000. That document defines "Investment Obligations" as:

- (a) *direct obligations of, or obligations the prompt payment of principal and interest on which are fully guaranteed by, the United States of America;*
- (b) *bonds, debentures, notes or other evidences of indebtedness issued or fully insured or guaranteed by any agency or instrumentality of the United States of America which is backed by the full faith and credit of the United States of America;*
- (c) *interest-bearing time or demand deposits, certificates of deposit or other similar banking arrangements with any Depository (including the Trustee), provided that such deposits, certificates and other arrangements are fully insured by the Federal Deposit Insurance Corporation or secured by obligations described in clauses (a) to (b), inclusive, of this definition, or a combination thereof;*
- (d) *money market funds or similar funds which invest exclusively in obligations described in clause (a), (b) or (e) of this definition, or a combination thereof;*
- (e) *bonds, debentures, notes or other evidences of indebtedness issued by any state of the United States of America or any political subdivision thereof or any public authority or body or instrumentality thereof which constitute obligations described in Section 103(a) of the Code which have a fixed parvalue and a fixed amount due at maturity and on call dates and are either rated "MIG 1" by Moody's and rated "SP-1+" by Standard & Poor's for short-term obligations or rated no lower than the rating on the Outstanding Bonds by Standard & Poor's and by Moody's;*
- (f) *any repurchase agreement or similar financial transaction with a national banking association (including the Trustee), a bank or trust company organized under the laws of any state, or a government bond dealer reporting to, trading with and recognized as a primary dealer by the Federal Reserve Bank of New York or other corporation, association or entity which has a long-term debt rating by Standard & Poor's and Moody's no lower than the rating on the Outstanding Bonds, which agreement is secured by a perfected security interest in any one or more of the securities described in clause (a) or (b) and which have an aggregate market value at least equal to the amount invested;*

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

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

- (g) *investment contracts issued, secured or guaranteed by a corporation (or its guarantor), a national banking association or a state banking association which has a long-term debt rating by Standard & Poor's and Moody's no lower than the rating on the Outstanding Bonds, or by a foreign bank or a United States branch or agency of a foreign bank, which foreign bank consents to in personam jurisdiction and which has a long-term debt rating by Standard & Poor's and Moody's no lower than the rating on the Outstanding Bonds;*
or
- (h) *obligations of an insurance company which has a long-term debt rating by Standard & Poor's and Moody's no lower than the rating on the Outstanding Bonds.*

Interest Rate Risk: Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. For the investments held by the Trustee, the program does not have a formal investment policy that limits investment maturities as a means of managing exposure to fair value losses arising from increasing interest rates. At June 30, 2014, the amounts held by the Trustee had the following investments and maturities in years: Money Market funds do not have a maturity. The CDC Funding Corp. GIC investments have a maturity date of July 1, 2015.

The amounts held by the Trustee in GICs were investments, as defined by GASB. The Trustee, in accordance with the Series 2000A Supplemental Bond Indenture, invests funds in a private debt obligations fund, which is considered a debt security. This debt security has the following risks:

- Credit Risk – Credit risk is a risk that an issuer of debt securities or another counterparty to an investment transaction will not fulfill an obligation and is commonly expressed in terms of the credit quality rating issued by a national rating organization. The CDC Funding Corporation GIC was rated A-1 by Standard & Poor's Rating Group.
- Custodial Credit Risk of Investments – Custodial credit risk of investments is the risk that, in the event of the failure of a counterparty, the Program will not be able to recover the value of its investments of 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 67% of its total investments in the GIC fund.

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

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

3. Loans Receivable

As of June 30, 2014, the Program had 104 outstanding community loans that totaled \$95,543,889. The outstanding balances of the 10 communities with the largest loan balances, which represent 56.0% of the total loans, were as follows:

Community	Outstanding Balance
Lincoln	\$ 11,825,609
McCook	7,224,194
Gering	6,120,631
North Platte	5,221,224
Metropolitan Utilities District	5,195,475
Auburn	4,182,948
Sidney	4,178,747
Blair	3,917,431
Alliance	3,484,730
Beaver Lake Association	2,131,096
TOTAL	\$ 53,482,085

4. Capital Assets

The Drinking Water SRF capital assets activity for the year ended June 30, 2014, was:

	Beginning Balance	Increases	Decreases	Ending Balance
Software Development In-Progress				
Loans and Grants Tracking System (LGTS)	\$ -	\$ 21,148	\$ -	\$ 21,148

5. Bonds Payable

The State has entered into a special financing arrangement with NIFA, an independent instrumentality of the State exercising essential public functions, to provide matching funds for the Program. NIFA issues the bonds, and the proceeds are held by the Trustee until they are needed by the Program for loan purposes.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

5. Bonds Payable (Concluded)

Short-Term Bonds: During the fiscal year, the Program issued Series 2013 short-term revenue bonds to meet the requirement of matching each capitalization grant with 20% of non-Federal funds. Bond Series 2013 was retired during the fiscal year ended June 30, 2014. Bonds Payable activity for fiscal year 2014 on the short-term bonds was as follows:

	Beginning Balance	Additions	Retirements	Ending Balance
Bonds Payable	\$ -	\$ 1,685,000	\$ 1,685,000	\$ -

Long-Term Bonds: The Series 2000A, 2008A, and 2010A

	Beginning Balance	Additions	Retirements	Ending Balance	Current Portion
Bonds Payable	\$ 6,315,000	\$ -	\$ 750,000	\$ 5,565,000	\$ 780,000

Bonds Payable at June 30, 2014, consisted of the following:

Series	Original Issue	Retirements	2014 Balance	Interest Rate	Final Maturity Date
2000A	\$ 5,530,000	\$ 4,065,000	\$ 1,465,000	4.8-5.7%	July 1, 2015
2008A	1,965,000	580,000	1,385,000	2.75-5.0%	Jan. 1, 2023
2010A	3,110,000	395,000	2,715,000	.9-4.0%	July 1, 2025

The 2000A Series Bonds were issued June 29, 2000. The Series 2008A Bonds were issued October 3, 2008, and the Series 2010A Bonds were issued November 12, 2010. Bonds mature at various intervals through July 2025.

The debt service requirements on bonds maturing in subsequent years are as follows:

Year Ending June 30	Principal	Interest	Total
2015	\$ 780,000	\$ 220,288	\$ 1,000,288
2016	1,350,000	170,135	1,520,135
2017	340,000	131,805	471,805
2018	355,000	121,093	476,093
2019	365,000	108,859	473,859
2020-2024	1,850,000	329,998	2,179,998
2025-2026	525,000	21,100	546,100
TOTAL	\$ 5,565,000	\$ 1,103,278	\$ 6,668,278

Federal arbitrage regulations are applicable to these bonds.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

6. Noncurrent Liabilities

Changes in noncurrent liabilities for the year ended June 30, 2014, were as follows:

	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>	<u>Amounts Due Within One Year</u>
Compensated Absences	\$ 20,489	\$ 217	\$ -	\$ 20,706	\$ 1,449

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, 2014. 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, 2014, and may have been drawn over multiple years.

Federal Fiscal Year Available	Grant Amount	Amount Drawn	Balance
1997	\$ 12,824,000	\$ 12,824,000	\$ -
1998	7,121,300	7,121,300	-
1999	7,463,800	7,463,800	-
2000	7,757,000	7,757,000	-
2001	7,789,126	7,789,126	-
2002	8,052,500	8,052,500	-
2003	8,004,100	8,004,100	-
2004	8,303,100	8,303,100	-
2005	8,285,500	8,285,500	-
2006	8,229,300	8,229,300	-
2007	8,229,000	8,229,000	-
2008	8,146,000	8,146,000	-
2009 - ARRA	19,500,000	19,500,000	-
2009	8,146,000	8,146,000	-
2010	13,573,000	12,369,256	1,203,744
2011	9,418,000	5,972,149	3,445,851
2012	8,695,558	5,398,654	3,296,904
2013	8,533,907	2,858,033	5,675,874
TOTAL	\$ 168,071,191	\$ 154,448,818	\$ 13,622,373

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

7. **Capital Contributions** (Concluded)

The 2014 grant was awarded on July 2, 2014, after the end of State fiscal year 2014. The award was for \$10,614,000, which consisted of \$8,845,000 in Federal dollars and \$1,769,000 in State match dollars. Not included in the above Grant totals are the amounts set aside as in-kind contributions for the Loans Grant Tracking System (LGTS) software development. The 2012 grant had \$166,535 set aside as in-kind amounts for use by the EPA for the cost of the development of the new LGTS software. The amount expended/drawn down for the LGTS software for fiscal year ending June 30, 2014, was \$14,706.

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

Contributed Capital July 1, 2013	\$ 146,754,037
Contributed During the Year:	
Funds from EPA	9,969,280
Funds from ARRA	-
Contributed Capital June 30, 2014	<u>\$156,723,317</u>

Also included in the contributed capital is a total of all general funds received by the Program from the Legislature of the State of Nebraska. These assets were to be used as match for the Program for the initial capitalization grant received by the State. The State contributed \$1,162,318 and \$1,166,518 in the fiscal years ended June 30, 1998 and 1999, respectively. Included in the Funds from the EPA amount is the reversal of the decrease in Due From Federal Government from the prior year of \$70,338, and the increase in Due From Federal Government from the current year of \$246,755. Due From Federal Government was also restated from the prior fiscal year by \$230,754 due to an unrecorded receivable.

Nebraska was awarded \$19,500,000 in American Recovery and Reinvestment Act (ARRA) funds for upgrades to public water systems. ARRA provided new, one-time funding, which was combined with existing funds from the Drinking Water State Revolving Fund. ARRA required the State to use at least 50% of the funds provided by this grant to offer additional subsidization in the form of loan forgiveness. ARRA funds did not require a State match.

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 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.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

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. Expenses were related to three set-aside activities established under §1452 of the Safe Drinking Water Act. The three set-aside activities are:

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

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

All set-asides are required to be Federally funded. State match dollars can only be used for the purpose of providing loans to owners of Public Water Supply Systems. Other significant categories of expenses are Loan Forgiveness and Administrative Costs from Fees.

The following is an explanation of these categories:

Administrative Costs from Fees

To meet the long-term administrative needs of the Program, an annual fee of up to 1% is charged against the outstanding principal on loans. This fee is deposited into a separate account and is used for administrative costs 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:

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

10. Operating Expenses (Concluded)

- 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;
- 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:

- 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.

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO THE FINANCIAL STATEMENTS
(Continued)

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 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 is 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 is 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, 2014, employees contributed \$10,036, and the Agency contributed \$15,656. 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)

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

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 typically self-insures for general liability, employee health care, employee indemnification, and workers' compensation. The State has chosen to purchase insurance for:

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

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

NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM

NOTES TO THE FINANCIAL STATEMENTS
(Concluded)

12. Contingencies and Commitments (Concluded)

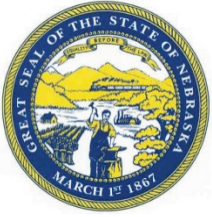
No settlements exceeded commercial insurance coverage in any of the past three fiscal years. Health care insurance is funded in the Insurance Trust Funds through a combination of employee and State contributions. Workers' compensation is funded in the Workers' Compensation Internal Service Fund through 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 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.

13. Restatement of Beginning Net Position

Beginning Net Position on the Statement of Revenues, Expenses, and Changes in Net Position was restated/increased by \$230,754 to adjust for an unrecorded receivable from the Federal government.

Beginning Cash and Cash Equivalents on the Statement of Cash Flows was restated/decreased by \$7,562,650 to adjust for a reclassification of certain Trustee investments from a Cash and Cash Equivalents designation to an Investment designation.



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

INDEPENDENT AUDITOR'S REPORT

Nebraska Department of Environmental Quality
Lincoln, Nebraska

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the business-type activities of the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program, as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program's basic financial statements, and have issued our report thereon dated April 10, 2015.

Internal Control Over Financial Reporting

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

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable

possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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

Compliance and Other Matters

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

The Nebraska Department of Environmental Quality's Response to Finding

We noted a certain matter that we reported to management of the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program in the Comments Section of this report as Comment Number 1 (Technical and Managerial Capabilities).

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

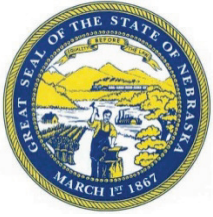
Purpose of this Report

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

Lincoln, Nebraska
April 10, 2015



Don Dunlap, CPA
Assistant Deputy Auditor



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NEBRASKA DEPARTMENT OF ENVIRONMENTAL QUALITY
DRINKING WATER STATE REVOLVING FUND PROGRAM
**REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER COMPLIANCE
WITH REQUIREMENTS APPLICABLE TO THE NEBRASKA DEPARTMENT OF
ENVIRONMENTAL QUALITY – DRINKING WATER STATE REVOLVING FUND
PROGRAM IN ACCORDANCE WITH THE OMB CIRCULAR A-133 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 Circular A-133 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, 2014.

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 OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 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, 2014.

Other Matters

The results of our auditing procedures disclosed an instance of noncompliance, which is required to be reported in accordance with OMB Circular A-133 and which is described in the Comments Section of this report as Comment Number 1 (Technical and Managerial Capabilities). Our opinion on the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program is not modified with respect to this matter.

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

Report on Internal Control Over Compliance

Management of the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program's internal control over compliance with the types of requirements that could have a direct and material effect on the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for the Nebraska Department of Environmental Quality – Drinking Water State Revolving Fund Program and to test and report on internal control over compliance in accordance with OMB Circular A-133, 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 compliance and 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 OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

Lincoln, Nebraska
April 10, 2015


Don Dunlap, CPA
Assistant Deputy Auditor