



Maryland
Environmental
Service

259 Najoles Road
Millersville, MD 21108

(A Component Unit of the State of Maryland)

Financial Statements

Fiscal Years Ended June 30, 2013 and 2012

(With Independent Public Accountants' Report Thereon)

TABLE OF CONTENTS

	Page
FINANCIAL SECTION	
Report of Independent Public Accountants	1
Management Discussion and Analysis	3
Statements of Net Position	13
Statements of Revenue, Expenses and Changes in Net Position	14
Statements of Cash Flows	15
Midshore Regional Landfill Private Purpose Trust Fund Statements of Net Position	16
Midshore Regional Landfill Private Purpose Trust Fund Statements of Revenue, Expenses and Changes in Net Position	17
Other Post Employment Benefit Plan Statement of Plan Net Position	18
Other Post Employment Benefit Plan Statement of Changes in Plan Net Position	19
Notes to Financial Statements	20
Required Supplemental Information for Other Postemployment Benefit Plan	43
Report of Independent Public Accountants on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	44



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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors
Maryland Environmental Service

Report on the Financial Statements

We have audited the accompanying financial statements of the business type activities and fiduciary funds of the Maryland Environmental Service (the Service), a component unit of the State of Maryland, as of and for the years ended June 30, 2013 and 2012, and the related notes to the financial statements, which collectively comprise the Service's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

The Service's 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 financial position of the Service as of June 30, 2013 and 2012, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.



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Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management Discussion and Analysis and Required Supplementary Information for Other Postemployment Benefit Plan on pages 3-12 and 44 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated September 30, 2013, on our consideration of the Service's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Service's internal control over financial reporting and compliance.

Hunt Valley, Maryland
September 30, 2013

SB & Company, LLC

**Maryland Environmental Service
Management's Discussion and Analysis
June 30, 2013 and 2012
(In thousands except where noted)**

Overview of Financial Statements

Maryland Environmental Service (Service) is an independent agency of the State of Maryland that provides environmental services to both the public and private sectors on a fee for service basis. Substantially all the Service's revenue is derived from the delivery of technical and operational environmental services. The Service is organized into four basic groups: Environmental Operations, Water/Wastewater Operations, Technical and Environmental Services and Administration. The financial statements presented report and use accounting methods similar to those employed by private sector companies.

The purpose of the discussion and analysis that follows is to provide an understanding of the financial performance and activities of the Service as of and for the fiscal years ended June 30, 2013 and 2012. As required supplementary information, the accompanying analysis of financial information should be used in conjunction with the financial statements and related notes thereto included elsewhere to assess the overall financial condition and reported operating results of the Service.

The following table presents condensed financial information about the Service's net position as of June 30, 2013, 2012 and 2011:

**Net Position
(Expressed in Thousands)**

	2013	2012	2011
Current and other assets	\$ 73,678	\$ 64,435	\$ 62,368
Capital assets	15,466	15,775	14,617
Total assets	89,144	80,210	76,985
Current and long-term debt and capital leases	6,429	7,241	9,877
Other liabilities	63,115	54,240	50,598
Total liabilities	69,544	61,481	60,475
Net assets:			
Invested in capital assets, net of related debt	9,037	8,157	6,157
Restricted	11	11	11
Unrestricted	10,552	10,561	10,342
Total net position	\$ 19,600	\$ 18,729	\$ 16,510

**Maryland Environmental Service
Management's Discussion and Analysis
June 30, 2013 and 2012
(In thousands except where noted)**

Fiscal Year 2013

Net position represent the difference between total assets and total liabilities.

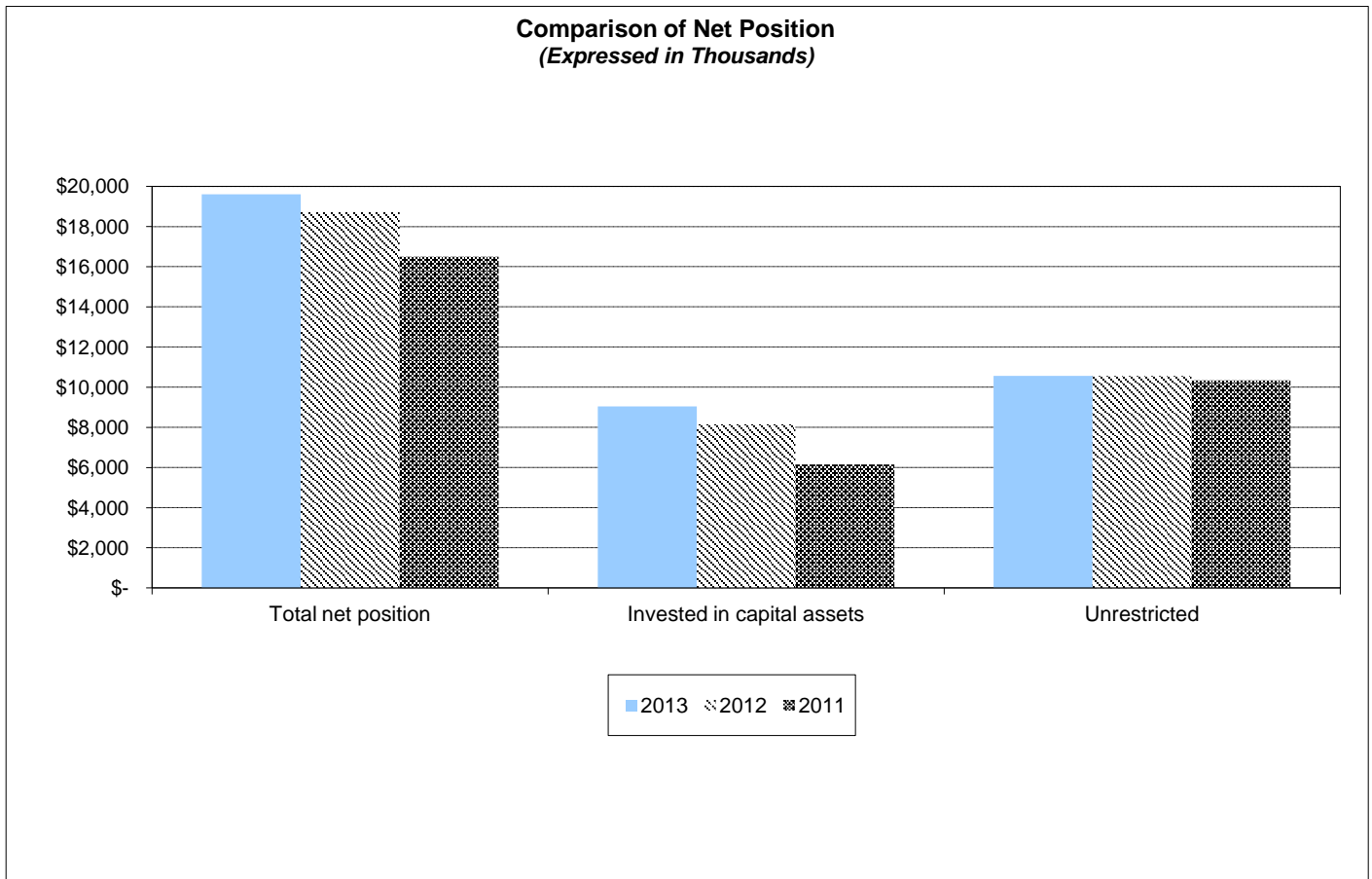
Total net position increased \$871 thousand in 2013 which is related to the excess of revenue over expenses. Invested in capital assets, net of related debt increased \$880 thousand from the payment of debt, net of depreciation. The remaining components, restricted and unrestricted net position of \$10,563 thousand, represent funds available for future expenditures. Over time, increases and decreases in net assets provide an indicator of improving or deteriorating financial position.

Fiscal Year 2012

Total net position increased \$2,219 thousand to \$18,729 thousand from 2011. The components of net position are invested in capital assets net of related debt, restricted and unrestricted net position.

Invested in capital assets, net of related debt reflects the equity in capital assets. The increase of \$2,000 thousand is the result of net additions in capital assets of \$1,021 thousand and payment of related debt of \$979 thousand. Unrestricted net position increased \$219 thousand. This portion of the Service's net position is the residual balance of net position excluding investment in capital assets net of related debt and restricted net position.

A comparison of years ended June 30, 2013, 2012 and 2011, are presented graphically below:



Maryland Environmental Service
Management's Discussion and Analysis
June 30, 2013 and 2012
(In thousands except where noted)

The following table presents condensed financial information about the Service's revenue, expenses and changes in net position for the years ended June 30, 2013, 2012 and 2011:

Changes in Net Position
(Expressed in Thousands)

	2013	2012	2011
Total operating revenue	\$ 93,923	\$ 105,904	\$ 108,762
Operating expenses			
Salaries and benefits	39,545	40,270	38,466
Other	41,312	50,995	55,786
General and administrative	11,859	11,928	12,283
Total operating expenses	92,716	103,193	106,535
Operating income	1,207	2,711	2,227
Nonoperating expense, net	(336)	(492)	(1,648)
Change in net position	871	2,219	579
Net position, beginning of year	18,729	16,510	15,931
Net position, end of year	\$ 19,600	\$ 18,729	\$ 16,510

The following table presents revenue by business type activity for the years ended June 30, 2013, 2012 and 2011:

Revenue by Business Type Activity
(Expressed in Thousands)

	2013	2012	2011
Environmental Dredging & Restoration	\$ 20,816	\$ 23,924	\$ 28,063
Water/Wastewater Operations	21,839	21,920	21,825
Recycling	12,139	16,817	15,225
Solid Waste Management	12,118	11,363	8,379
Energy Co-Generation	6,162	6,666	6,371
Environmental Engineering	2,244	2,303	2,170
Environmental Monitoring	11,888	15,015	16,758
Hazardous Waste Treatment	4,881	5,846	5,034
Grants	1,215	1,666	4,717
Other	621	384	220
Total Revenue	\$ 93,923	\$ 105,904	\$ 108,762

**Maryland Environmental Service
Management's Discussion and Analysis
June 30, 2013 and 2012
(In thousands except where noted)**

Revenue by Business Type Activity

Fiscal Year 2013

Total operating revenue for the year ended June 30, 2013, decreased \$11,981 thousand from 2012. The change represents a decrease of 11% in operating revenue. The most significant areas of change were decreases in Recycling of \$4,678 thousand, Environmental Dredging and Restoration of \$3,108 thousand, Environmental Monitoring of \$3,127, and Grant revenue of \$451 thousand. There was an increase in Solid Waste Management of \$755 thousand.

Recycling was lower as a result of the completion of the Garner/Brandywine Scrap Tire Cleanup in 2012. Environmental Dredging and Restoration revenue was lower mainly due to the tapering off of the Masonville Dredged Material Containment Facility construction project. The decrease to Environmental Monitoring was due to the expiration of several Memorandums of Understanding (MOU) with Department of Transportation modals. Federal grants with the Environmental Protection Agency, and Department of Transportation Maritime Administration had reduced expenditures in 2013 as projects near completion. Solid Waste Management revenue increase was related to design work and a slight increase in demand at the Baltimore County Resource Recovery Facility.

Fiscal Year 2012

Overall total revenue of \$105,904 thousand decreased \$2,858 thousand or 3% compared to prior year. The major segments that contributed to the change were Environmental Dredging and Restoration revenue decreases of \$4,139 thousand, and Grants revenue decreases of \$3,051 thousand. This was offset by an increase in Recycling revenue of \$1,592 thousand and Solid Waste Management of \$2,984 thousand.

Environmental Dredging and Restoration revenue was lower due to several large projects ending in 2011. Federal grants with the Environmental Protection Agency, and Department of Transportation Maritime Administration had significantly reduced expenditures in 2012 as the projects are near completion. Recycling revenue increased 10% to \$16,817 thousand due to two new scrap tire dump cleanup projects. Solid Waste Management revenue increase was related solely to the startup of a solid waste transfer station and home owner drop off undertaking.

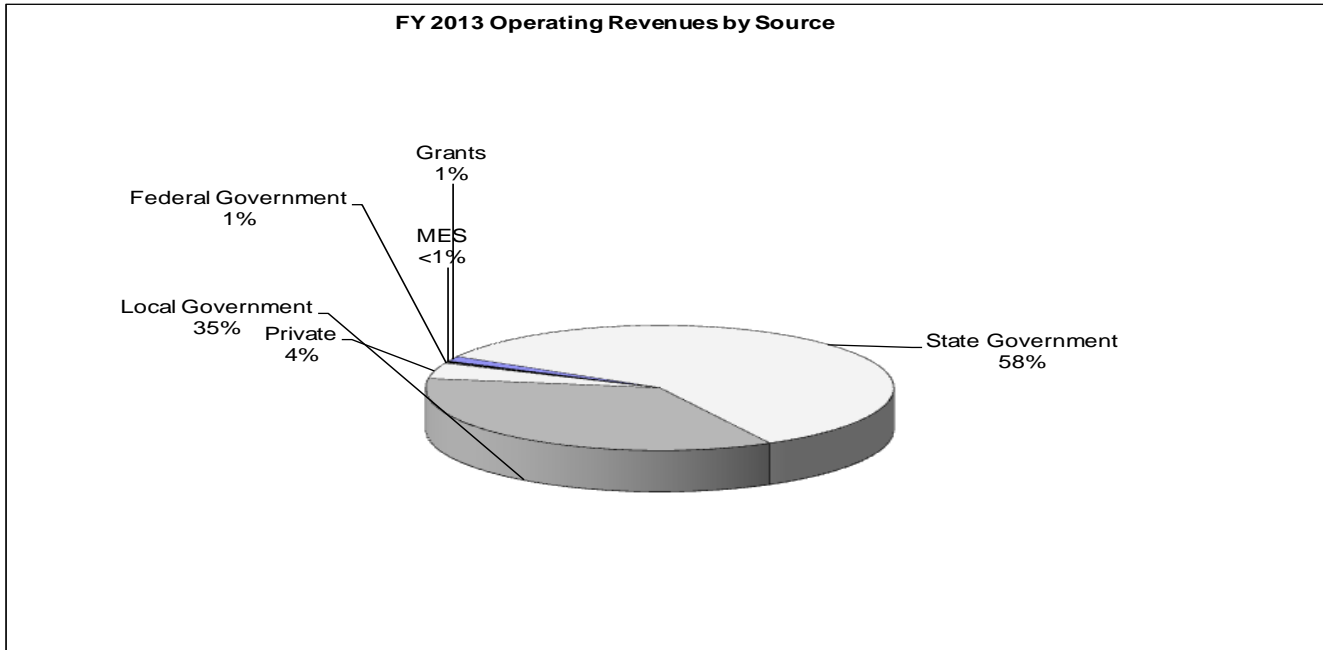
**Maryland Environmental Service
Management's Discussion and Analysis
June 30, 2013 and 2012
(In thousands except where noted)**

The following table presents revenue by source for the years ended June 30, 2013, 2012 and 2011:

**Revenue by Source
(Expressed in Thousands)**

	2013	2012	2011
State government	\$ 55,317	\$ 66,813	\$ 68,093
Local government	32,999	32,590	31,506
Private	3,838	4,293	3,800
Federal government	207	270	374
MES product revenues	347	272	272
Grants	1,215	1,666	4,717
Total Revenue	\$ 93,923	\$ 105,904	\$ 108,762

The following graph presents revenue by source for the year ended June 30, 2013:



Maryland Environmental Service
Management's Discussion and Analysis
June 30, 2013 and 2012
(In thousands except where noted)

Revenue by Source

Fiscal Year 2013

State government revenues decreased by \$11,496 thousand in 2013, while local government revenue increased by \$409 thousand. Grant revenue declined by \$451 thousand.

State revenue reductions were attributable to the Masonville Dredged Material Containment Facility construction project wrap up, and the expiration of several MOUs with the Maryland Department of Transportation. Federal grants with the Environmental Protection Agency, and Department of Transportation Maritime Administration had reduced expenditures in 2013 as the Garner/Brandywine Scrap Tire Cleanup was completed, and environmental review services work ended.

Fiscal Year 2012

State and local government revenues account for 94% of total revenues. State government revenue decreased \$1,280 thousand from last year and local government increased \$1,084 thousand for a net decrease of \$196 thousand. Grant revenue was the largest change in total revenue accounting for a decrease of \$3,051 thousand.

The near completion of the Masonville Dredging and Construction Federal grants with the Environmental Protection Agency, and Department of Transportation Maritime Administration had significantly reduced expenditures in 2012 as the projects are near completion.

Operating Expenses

Operating expenses are predominantly related to those classified as cost of goods and services, general and administrative, and depreciation on capital assets. Operating expenses were 99%, 97%, and 98% of revenue in 2013, 2012 and 2011, respectively.

Operating Income

Fiscal Year 2013

Operating income reported in 2013 was \$1,207 thousand compared to \$2,711 thousand in 2012, a decrease of \$1,504 thousand. The factors affecting the change are a combination of lower overhead recovery and project variances.

Fiscal Year 2012

In 2012, the Service reported operating income of \$2,711 thousand compared to operating income of \$2,227 thousand in 2011, an increase of \$484 thousand. The principal reason for the increase is due to a change in the fringe benefit recovery rate and lower general and administrative expenses.

**Maryland Environmental Service
Management's Discussion and Analysis
June 30, 2013 and 2012
(In thousands except where noted)**

Non-operating Revenue (Expense), Net

Fiscal Year 2013

Non-operating expenses, (net) decreased \$156 thousand to \$336 thousand in 2013. Non-operating items primarily include interest income and interest expense. For 2013, interest income increased by \$12 thousand and interest expense decreased by \$167 thousand.

Fiscal Year 2012

Non-operating expenses, (net) decreased \$1,156 thousand to \$492 thousand in 2012. The major reason for the decrease is a nonrecurring contribution to the State's General Fund of \$1,075 thousand made in 2011.

Grants

Fiscal Year 2013

Operating grants in 2013 totaled \$1,215 thousand compared to \$1,666 thousand in 2012. Federal grants with the Environmental Protection Agency, and Department of Transportation Maritime Administration had very little activity as projects were completed.

Fiscal Year 2012

Operating grants in 2012 totaled \$1,666 thousand compared to \$4,717 thousand in 2011, a decrease of \$3,051 thousand. Federal grants with the Environmental Protection Agency, and Department of Transportation Maritime Administration had significantly reduced expenditures in 2012 as the projects are near completion.

**Maryland Environmental Service
Management's Discussion and Analysis
June 30, 2013 and 2012
(In thousands except where noted)**

Investment in Capital Assets

The following tables present capital assets, net of depreciation as of June 30, 2013, 2012 and 2011, and capital expenditures for the years ended June 30, 2013, 2012 and 2011:

**Capital Assets, Net of Depreciation
(Expressed in Thousands)**

	2013	2012	2011
Land and improvements	\$ 1,040	\$ 1,223	\$ 1,223
Buildings and improvements	7,909	8,337	8,765
Infrastructure	293	424	431
Machinery and equipment	6,224	5,791	4,198
Construction in progress, net change	-	-	-
Total	\$ 15,466	\$ 15,775	\$ 14,617

**Capital Expenditures
(Expressed in Thousands)**

	2013	2012	2011
Land and improvements	\$ -	\$ -	\$ -
Autos and trucks	1,151	728	332
Construction and production equipment	84	782	19
Computer hardware/software	381	1,325	251
Tools/machinery/equipment	132	-	5
Buildings	-	-	211
Leasehold improvements	-	70	-
Construction in progress, net change	-	-	(211)
Total	\$ 1,748	\$ 2,905	\$ 607

Fiscal Year 2013

As of June 30, 2013, the carrying value of capital assets, net of depreciation was \$15,466 thousand, a decrease of \$309 thousand from 2012. The decrease is comprised of capital additions of \$1,748 thousand, net disposals of \$795 thousand, and depreciation of \$1,262 thousand. The capital additions for the year were fleet vehicle replacements, JD Edwards ERP system, and construction equipment.

Fiscal Year 2012

As of June 30, 2012, the Service had invested \$15,775 thousand in capital assets, net of depreciation in various categories. Overall, capital assets increased \$1,158 thousand in 2012. The change from prior year is comprised of capital additions \$2,905 thousand, depreciation of \$1,702 thousand, and net asset retirements of \$45 thousand. The bulk of capital additions in 2012 was for a major systems upgrade of the Service's JD Edwards ERP system, fleet vehicle replacements and construction equipment.

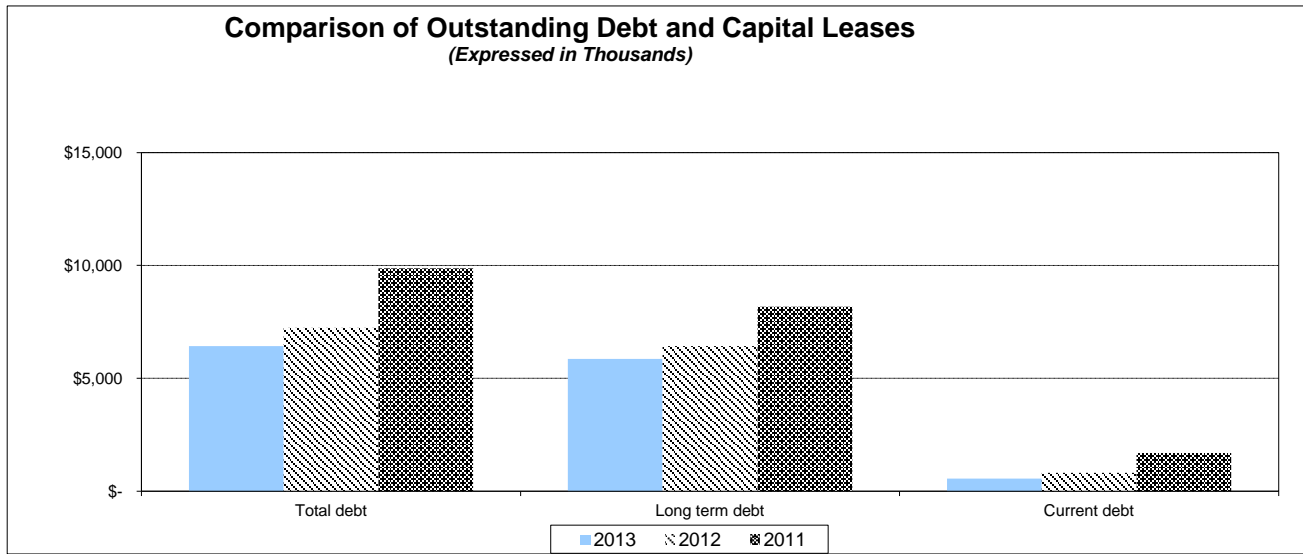
**Maryland Environmental Service
Management's Discussion and Analysis
June 30, 2013 and 2012
(In thousands except where noted)**

Outstanding Debt

The following table and graph present outstanding debt as of June 30, 2013, 2012 and 2011:

**Outstanding Debt and Capital Leases
(Expressed in Thousands)**

	2013	2012	2011
Revenue bonds	\$ -	\$ -	\$ 1,359
Capital leases	6,037	6,813	8,055
General obligation bond-note	392	428	463
Total	\$ 6,429	\$ 7,241	\$ 9,877



Fiscal Year 2013

As of June 30, 2013, outstanding debt was \$6,429 thousand, representing a net decrease in borrowing of \$812 from 2012. The net decrease consists of principal payments.

Fiscal Year 2012

As of June 30, 2012, outstanding debt of \$7,241 thousand consisted of bond debt of \$428 thousand and capital leases of \$6,813 thousand. The net decrease of \$2,636 thousand from 2011 is all due to principal payments.

**MARYLAND ENVIRONMENTAL SERVICE
FINANCIAL STATEMENTS**

Maryland Environmental Service
Statements of Net Position
As of June 30, 2013 and 2012
(Expressed in Thousands)

Assets	2013	2012
Current assets:		
Cash and cash equivalents	\$ 44,388	\$ 34,965
Restricted cash	-	40
Investments	11,186	9,187
Accounts receivable (net of allowance of \$50)	11,494	13,424
Unbilled project costs accrued	3,457	3,752
Net investment direct financing leases	-	10
Other	83	56
Total current assets	70,608	61,434
Other assets:		
Restricted cash	345	359
Due from project participants	2,725	2,642
Capital assets, net of accumulated depreciation:		
Land	1,040	1,223
Buildings and improvements	7,909	8,337
Infrastructure	293	424
Machinery and equipment	6,224	5,791
Total capital assets	15,466	15,775
Total other assets	18,536	18,776
Total assets	89,144	80,210
Liabilities		
Current liabilities:		
Accounts payable and accrued expenses	8,833	10,009
Accrued annual leave	2,650	2,665
Due to Midshore and other projects	14,221	14,296
Advances from project participants	33,868	22,872
Current portion of long-term debt and capitalized leases	561	812
Accrued workers' compensation costs	422	410
Total current liabilities	60,555	51,064
Other liabilities:		
Advances from project participants	818	1,756
Long-term debt and capitalized leases, net of current portion and bond discount	5,868	6,429
Accrued workers' compensation costs	2,303	2,232
Total other liabilities	8,989	10,417
Total liabilities	69,544	61,481
Net Position		
Net investment in capital assets	9,037	8,157
Restricted net position	11	11
Unrestricted net position	10,552	10,561
Total net position	\$ 19,600	\$ 18,729

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

Maryland Environmental Service
Statements of Revenue, Expenses and Changes in Net Position
For the years ended June 30, 2013 and 2012
(Expressed in Thousands)

	2013	2012
Operating revenue:		
Charges for services	\$ 92,708	\$ 104,238
Operating grants	1,215	1,666
Total operating revenue	93,923	105,904
Operating expenses:		
Salaries and benefits	39,545	40,270
Contractual services	14,752	22,108
Technical fees	6,747	5,901
Utilities	4,550	4,205
Repairs and maintenance	4,464	4,729
Materials and supplies	5,831	6,898
Land, structures and equipment	2,918	4,950
Depreciation	1,732	1,702
General and administrative	11,859	11,928
Other	318	502
Total operating expenses	92,716	103,193
Operating income	1,207	2,711
Nonoperating revenue (expenses):		
Investment income	23	11
Interest expense	(360)	(527)
Gain on sale of equipment, net	1	24
Nonoperating expenses, net	(336)	(492)
Change in net position	871	2,219
Net position, beginning of year	18,729	16,510
Net position, end of year	\$ 19,600	\$ 18,729

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

Maryland Environmental Service
Statements of Cash Flows
For the years ended June 30, 2013 and 2012
(Expressed in Thousands)

	2013	2012
Cash Flows From Operating Activities		
Receipts from customers	\$ 96,148	\$ 108,766
Payments to suppliers	(52,629)	(64,811)
Payments to employees	(39,545)	(40,179)
Payments to/from project participants	9,976	1,966
Other payments project Midshore	(75)	4,699
Other	119	375
Net cash from operating activities	13,994	10,816
Cash Flows From Capital and Related Financing Activities		
Purchases of capital assets	(1,473)	(2,825)
Principal paid on capital debt	(812)	(2,636)
Interest paid on capital debt	(360)	(526)
Increase on lease	10	766
Other receipts	1	23
Net cash from capital and related financing activities	(2,634)	(5,198)
Cash Flows From Investing Activities		
Purchases of investments	(6,000)	(10,500)
Sales and maturities of investments	4,039	4,031
Interest and dividends	24	11
Net cash from investing activities	(1,937)	(6,458)
Net changes in cash and cash equivalents	9,423	(840)
Cash and cash equivalents - beginning of the year	34,965	35,805
Cash and cash equivalents - end of the year	\$ 44,388	\$ 34,965
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 1,207	\$ 2,711
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation expense	1,732	1,702
Change in assets and liabilities:		
Receivables, net	1,935	2,565
Other assets	244	196
Accounts and other payables	(1,191)	(3,500)
Due to project participants	10,059	2,204
Net change due to/from Midshore	(75)	4,700
Accrued workers compensation	83	238
Net cash from operating activities	\$ 13,994	\$ 10,816

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

Midshore Regional Landfill Private Purpose Trust Fund

Statements of Net Position

As of June 30, 2013 and 2012

(Expressed in Thousands)

Assets	2013	2012
Current assets:		
Cash and cash equivalents	\$ 71	\$ 45
Due from MES	14,221	14,290
Accounts receivable	429	380
Other	2	-
Total current assets	14,723	14,715
Other assets:		
Restricted investments	2,144	2,359
Bond issuance cost	100	105
Capital assets not depreciated	1,864	1,690
Capital assets being depreciated, net	18,751	19,782
Total capital assets	20,615	21,472
Total other assets	22,859	23,936
Total assets	37,582	38,651
Liabilities		
Current liabilities:		
Accounts payable and accrued expenses	194	224
Advances from project participants	483	483
Due to Midshore Recycling	-	456
Current portion of long-term debt and capitalized leases	732	945
Total current liabilities	1,409	2,108
Other liabilities:		
Long-term debt and capitalized leases, net of current portion and bond discount	18,593	19,329
Accrued landfill closure & postclosure care costs	9,792	9,646
Total other liabilities	28,385	28,975
Total liabilities	29,794	31,083
Net Position		
Invested in capital assets, net of related debt	1,290	1,197
Net assets designated-closure/post closure	5,282	4,951
Net assets designated-Easton	870	870
Unrestricted net position	346	550
Total net position	\$ 7,788	\$ 7,568

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

Midshore Regional Landfill Private Purpose Trust Fund
Statements of Revenue, Expenses and Changes in Net Position
For the years ended June 30, 2013 and 2012
(Expressed in Thousands)

	2013	2012
Operating revenue:		
Charges for services	\$ 5,160	\$ 6,258
Operating expenses:		
Salaries and benefits	1,093	1,161
Contractual services	149	661
Technical fees	57	81
Utilities	36	143
Operations and maintenance	505	439
Materials and supplies	174	173
Land, structures and equipment	78	172
Depreciation	1,050	1,052
Closure/post closure	598	989
General and administrative	342	351
Other, net	79	(99)
Total operating expenses	4,161	5,123
Operating income (loss)	999	1,135
Nonoperating revenue (expenses):		
Interest income	49	13
Interest expense	(828)	(862)
Nonoperating expenses, net	(779)	(849)
Change in net position	220	286
Net position, beginning of year	7,568	7,282
Net position, end of year	\$ 7,788	\$ 7,568

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

MARYLAND ENVIRONMENTAL SERVICE

Other Post Employment Benefit Plan

Statement of Plan Net Position

As of June 30, 2013

(Expressed in Thousands)

Assets	
Cash and short-term investments	\$ 174
Investments:	
Equities	1,156
Fixed income	256
Real estate	73
Other	42
Total investments	1,527
Total assets	1,701
Net position held in trust for other postemployment benefits	\$ 1,701

The accompanying notes are an integral part of this financial statement.

MARYLAND ENVIRONMENTAL SERVICE	
Other Post Employment Benefit Plan	
Statement of Changes in Plan Net Position	
For the year ended June 30, 2013	
(Expressed in Thousands)	
Additions	
Employer contributions	\$ 288
Investment Income	
Net appreciation in fair value of investments	149
Interests and dividends	29
	178
Less investment expense	5
Net investment income	173
Total additions	461
Deductions	
Benefits paid	55
Net increase	406
Net position held in trust for other postemployment benefits	
Net position, beginning of year	1,295
Net position, end of year	\$ 1,701

The accompanying notes are an integral part of this financial statement.

Maryland Environmental Service
Notes to Financial Statements
June 30, 2013 and 2012
(In thousands except where noted)

(1) Organization and Summary of Significant Accounting Policies

(a) Reporting Entity

The General Assembly created Maryland Environmental Service (the Service) in 1970 as an agency of the Maryland State Department of Natural Resources. Major activities of the Service include the provision of water supply and wastewater treatment, sewage sludge management, recycling assistance, solid waste management, and resource recovery from waste and dredging services. Services are provided to State of Maryland owned facilities, local communities, political subdivisions, Federal facilities, and the private sector.

Pursuant to Chapter 196 of the 1993 Acts of the Maryland General Assembly, effective July 1, 1993, the Service was established as an instrumentality of the State and a public corporation independent of the Department of Natural Resources. Chapter 196 also expanded the Service's Board of Directors from seven to nine members; provided for the appointment of the Deputy Director, Secretary and Treasurer by the Director, with the approval of the Governor; provided for the appointment of the remaining Board members by the Governor, with the advice and consent of the Senate; exempted the Service from most provisions of the State Procurement Law; established the retirement and health benefits available for certain employees of the Service; authorized the Service to create a new personnel system; exempted the Service from most provisions of the State Merit System Law effective January 1, 1995; authorized the Service to create private corporations; authorized the Service to exercise the corporate powers granted Maryland corporations under the Maryland General Corporation Law; and made other changes to the law governing the Service. For financial reporting purposes, the Service is considered a component unit of the State of Maryland.

The Service operates public and private water and wastewater treatment plants throughout the State of Maryland. Licensed and certified personnel operate and maintain the facilities. Projects range in size from basic pumping stations to advanced wastewater treatment facilities. Capabilities include laboratory testing, operations oversight, and management, operations, maintenance and plant supervision.

In the area of solid waste management, the Service operates state-of-the-art waste facilities including municipal solid waste and rubble landfills, incinerators, resource reclamation facilities in Baltimore and Montgomery Counties, and transfer stations in Baltimore County.

The Service has the capabilities to provide site analysis, planning, engineering, design and construction services, and the resources to finance and build water, wastewater and solid waste projects. The Service operates the Hart-Miller Island, Poplar Island, and Cox Creek Dredge Disposal Facilities as well as provides technical support for the Maryland Port Administration.

The Service produces and sells yard waste compost for Montgomery, Baltimore, Anne Arundel, Howard and Prince George's Counties under the registered trademark Leafgro®.

Certain employees of the Service are eligible to participate in the Retiree Medical Reimbursement Plan (OPEB Plan), which is a single employer defined benefit plan administered by the Service. The plan is considered part of the Service's financial reporting entity. A separate report for the OPEB Plan is prepared.

Maryland Environmental Service
Notes to Financial Statements
June 30, 2013 and 2012
(In thousands except where noted)

(1) Organization and Summary of Significant Accounting Policies (continued)

(b) Measurement focus, basis of accounting, and financial statement presentation

The accompanying financial statements, which are all business type activities, present the financial position and results of operations of all of the Service's activities. The Service utilizes the accrual basis of accounting and the economic measurement focus in preparing its financial statements wherein revenues are recognized when earned and expenses are recognized when incurred.

The Service also reports a private purpose trust fund. The purpose of this fund is to account for the operations of the Midshore Regional Landfills. The landfills, located in Talbot County, Maryland and Caroline County, Maryland, are operated for the benefit of the governments of Caroline, Kent, Queen Anne's and Talbot Counties. The counties have the ultimate responsibility for payment of operating expenses and debt of the facility.

(c) Revenue Recognition

The Service distinguishes operating revenue and expenses from nonoperating items. Operating revenue and expenses generally result from providing services and producing and delivering goods in connection with ongoing operations. The principal operating revenue of the Service are charges to customers for services. Operating expenses include the cost of services, administrative expenses, and depreciation on capital assets. All revenue and expenses not meeting this definition are reported as nonoperating revenue and expenses. Interest income is recognized as nonoperating revenue as earned, of which less than \$1 thousand and \$1 thousand during the years ended June 30, 2013 and 2012, respectively, was restricted for bond related activities. Grants and similar items are recognized as soon as all eligibility requirements imposed by the provider have been met.

(d) Cash Equivalents

The Service's cash is considered to be cash on hand and demand deposits. Cash equivalents include overnight investment funds.

(e) Investments

Investments are recorded at fair value, which is based on quoted market prices.

(f) Direct Financing Leases

The Service acts as lessor in direct financing lease arrangements for certain customer's projects and equipment. Such leases expired during fiscal year 2013 along with the related debt.

Maryland Environmental Service
Notes to Financial Statements
June 30, 2013 and 2012
(In thousands except where noted)

(1) Organization and Summary of Significant Accounting Policies (continued)

(g) Capital Assets

Capital assets are stated at cost and consist primarily of Service-owned assets related to projects operated for participants. Certain contracts contain provisions whereby the participants have the option to purchase certain equipment during the terms of the contracts.

The Service defines capital assets as assets with an initial, individual cost of more than \$5,000 (amount not rounded to thousands) and an estimated useful life in excess of one year. The costs of normal maintenance and repairs that do not add to the value of the assets or materially extend an assets' life are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred net of interest earned during the construction phase of capital assets is included as part of the capitalized value of the assets constructed. No interest was capitalized in fiscal year 2013 and 2012.

Depreciation is computed using the straight-line method over the estimated useful lives of the capital assets, which range from 3 to 40 years. For purposes of the statements of revenue, expenses and changes in net position, the depreciation on assets, which are not directly related to projects, are included in general and administrative expenses and product costs.

Certain contracts contain provisions whereby the Service purchases equipment or constructs assets for clients. These expenses are recorded as land, structures and equipment in the statements of revenue, expenses and changes in net position and are not capitalized.

(h) Compensated absences

Employees of the Service based on time in service earn vacation benefits. The rights to such benefits are vested and recorded as earned. Sick leave is also earned and accumulated by employees based on time in service. However, such benefits do not vest and are not paid or recorded unless sickness causes employees to be absent.

(i) Other Post-Employment Benefits (OPEB)

Plan Description. The Service provides a self-funded medical reimbursement plan to eligible employees not covered under the State Retiree Medical Plan. To be eligible, employees must retire at age 60 or older and have 16 years of employment with the Service. Retired employees or their spouses ages 60 and over can be reimbursed up to \$3,600 per calendar year for medical expenses. Retirees are not required to contribute to the plan.

Maryland Environmental Service
Notes to Financial Statements
June 30, 2013 and 2012
(In thousands except where noted)

(1) Organization and Summary of Significant Accounting Policies (continued)

(i) Other Post-Employment Benefits (OPEB) (continued)

Funding Policy. In 2010, the Service set up an irrevocable trust, the Maryland Environmental Service OPEB Trust Fund, for the sole purpose of funding post-employment benefits for current and future retirees. Contribution requirements are determined according to actuarial valuations. The Service contributed \$288 thousand in 2013 and \$271 thousand in 2012. Total reimbursement of medical expenses was \$55 thousand in 2013 and \$32 thousand in 2012.

Annual OPEB Cost and Net Obligation. The Service's annual other post-employment benefit (OPEB) cost (expense) is calculated based on the *annual required contribution of the employer (ARC)*, an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. For the fiscal years ended 2013 and 2012, the Service's annual OPEB cost was \$224 thousand and \$224 thousand, respectively. The net OPEB asset was \$5 thousand as of June 30, 2012 and was included in the other assets in the accompanying Statement of Net Position.

The following table shows the components of the Service's annual OPEB cost for the year.

OPEB Cost (In Thousands)	<u>2013</u>	<u>2012</u>
Normal cost	\$ 109	\$ 109
Minimum amortization of UAL	107	107
Interest adjustment to year- end	8	8
Annual required contribution / OPEB cost	<u>224</u>	<u>224</u>
Contributions made	<u>(288)</u>	<u>(271)</u>
Increase in net OPEB assets	(64)	(47)
Actuarial change in methods and adjustments	69	55
Net OPEB asset - beginning of year	<u>(5)</u>	<u>(13)</u>
Net OPEB asset - end of year	<u>\$ -</u>	<u>\$ (5)</u>

Maryland Environmental Service
Notes to Financial Statements
June 30, 2013 and 2012
(In thousands except where noted)

(1) Organization and Summary of Significant Accounting Policies (continued)

(i) Other Post-Employment Benefits (OPEB) (continued)

Funding Status and Funding Process. The funded status of the plan as of July 1, 2011, was as follows:

Actuarial valuation date	<u>7/01/2011</u>
Actuarial value of assets	\$ 1,111
Actuarial accrued liability	2,995
Unfunded actuarial liability	1,884
Funded ratio	37.1%
Annualized covered payroll	\$32,615
Ratio of unfunded actuarial liability to annual covered payroll	5.8%
Net OPEB assets as of the valuation date	\$ 5
Actuarial cost method	Entry age

As of the valuation date, the plan was 37.1% percent funded. The actuarial accrued liability for benefits was \$2,995 thousand resulting in an unfunded actuarial accrued liability of \$1,884 thousand.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the Service are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

Actuarial Methods and Assumptions. Projections of benefits for reporting purposes are based on the substantive plan (the plan as understood by the Service and plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of benefit costs of the Service to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with long-term perspective of the calculations.

In the July 1, 2011, actuarial valuation, the entry age actuarial cost method was used. The actuarial assumptions included a 7.5% estimated long-term investment yield on the investments that are expected to be used to finance the payment of benefits, which are the assets held in the trust.

A minor number of Service employees are enrolled in the State of Maryland's Retirement and Pension plans. These employees are eligible to receive medical coverage under the same conditions as State employees. Costs are billed by the State as a percentage markup of health insurance costs for current employees participating in the State Retirement and Pension plans. Total costs were \$81 thousand in 2013 and 2012.

Maryland Environmental Service
Notes to Financial Statements
June 30, 2013 and 2012
(In thousands except where noted)

(1) Organization and Summary of Significant Accounting Policies (continued)

(j) *Advances from Project Participants*

Advances from project participants are received by the Service as provided for under contracts and are generally for working capital purposes. Such advances are recorded as a liability and are generally refunded to project participants at the end of the related contracts.

(k) *Bond Discount*

Bond discount is amortized to interest expense using the interest method over the contractual term of the bonds.

(l) *Arbitrage*

The U.S. Treasury has issued regulations on calculating the rebate due to the Federal government on arbitrage profits and determining compliance with the arbitrage rebate provisions of the Tax Reform Act of 1986. Arbitrage profits arise when the Service temporarily invests the proceeds of tax-exempt debt in securities with higher yields. The Service treats the estimated rebate payable as a reduction of any interest income earned. As of June 30, 2013 and 2012, there were no arbitrage rebate liabilities.

(m) *Use of Estimates*

The preparation of financial statements in accordance 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 and disclosures of contingencies at the date the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from these estimates.

(n) *Recent Pronouncements*

The Governmental Accounting Standards Board (GASB) issued Statement No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements, in December 2010, effective for financial statement periods beginning after December 15, 2011. In November 2010, the GASB issued Statement No. 60, Accounting and Financial Reporting for Service Concession Arrangements, and Statement No. 61, The Financial Reporting Entity: Omnibus – an amendment of GASB Statements No. 14 and No. 34, effective for periods beginning after December 15, 2011 and June 15, 2012, respectively. In addition, in June 2011, the GASB issued Statement No. 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position, effective for periods beginning after December 15, 2011. The Service has implemented the above GASB statements, and they have no material effect on the financial position of the Service.

Maryland Environmental Service
Notes to Financial Statements
June 30, 2013 and 2012
(In thousands except where noted)

(1) Organization and Summary of Significant Accounting Policies (continued)

(n) Recent Pronouncements

In March 2012, the GASB issued Statement No. 65, Items Previously Reported as Assets and Liabilities, and Statement No. 66, Technical Corrections – 2012 – an amendment of GASB Statements No. 10 and No. 62, effective for periods beginning after December 15, 2012. In June 2012, the GASB issued Statement No. 67, Financial Reporting for Pension Plans – an amendment of GASB Statement No. 25, and Statement No. 68, Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27, effective for periods beginning after June 15, 2013, and 2014, respectively. In January 2013, GASB issued Statement No. 69, Government Combination and Disposals of Government Operations, effective for periods beginning after December 15, 2013. In April 2013, GASB issued Statement No. 70, Accounting and Financial Reporting for Non-exchange Guarantees, effective for periods beginning after June 15, 2013. The Service will implement these statements as of their effective dates. The Service is still in the process of determining the effect of implementing these GASB statements.

(2) Cash and Cash Equivalents and Investments

State statutes require that deposits and investments with financial institutions be fully collateralized. The investment policies for all of the Service's funds are the same as those of the State of Maryland Treasurer (Financial Procurement Article 6-222). The Service's cash is considered to be cash on hand and demand deposits. Cash and cash equivalents totaled \$44,388 thousand and \$34,965 thousand as of June 30, 2013 and 2012, respectively. Included, as cash equivalents for financial statement presentation, were certain overnight investments of \$45,120 thousand and \$36,653 thousand, respectively, as of June 30, 2013 and 2012, which are included in the investment discussion below. Investments are valued at fair value, which is based on quoted market prices.

The Finance and Procurement Article 6-222 defines the types of securities authorized as appropriate investments for the Service and the conditions for making investment transactions. Investment transactions may be conducted only through qualified depositories, certified dealers, or directly with issuers of the investment securities. The National Resource Article 3-126 authorizes the investment in obligation as described in the Finance and Procurement Article 6-222.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Service policy for managing its exposure to fair value loss arising from increasing interest rates is to comply with the State. The Service intends to hold investments until maturity to reduce adverse affect of changes in interest rates.

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Service's policy for reducing its exposure to credit risk is to comply with the State, which states that investments with financial institutions must be fully collateralized.

Maryland Environmental Service
Notes to Financial Statements
June 30, 2013 and 2012
(In thousands except where noted)

(2) Cash and Cash Equivalents and Investments (continued)

As of June 30, 2013, the Service had the following investments and quality ratings:

Investment Type	Ratings by Organization Moody's	Fair Value (In Thousands)	Investment Maturities (in Years)				
			Less than		More than		
			1	1-5	6-10	11-15	15
Bank of America FNMA	Aaa	\$ 5,000	\$ 5,000	\$ -	\$ -	\$ -	\$ -
Bank of America FNMA	Aaa	6,186	-	6,186			
Total		\$ 11,186	\$ 5,000	\$ 6,186	\$ -	\$ -	\$ -

As of June 30, 2013, the Midshore Regional Landfill had the following investments and quality ratings:

Investment Type	Ratings by Organization Moody's	Fair Value (In Thousands)	Investment Maturities (in Years)				
			Less than		More than		
			1	1-5	6-10	11-15	15
Money Market Funds	Aaa	\$ 1,585	\$ 1,585	\$ -	\$ -	\$ -	\$ -

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The Service's policy for reducing this risk of loss is to comply with State regulation.

The issuance of debt is authorized by National Resource Article 3-112. Each Bond issue includes a Tax and Section 148 Certificate, which specifies the investment type and yield requirements.

Restricted cash and investments include deposits and investments that relate to the bond indentures and restricted project funds, which are not available to pay the general operating expenses of the Service.

Maryland Environmental Service
Notes to Financial Statements
June 30, 2013 and 2012
(In thousands except where noted)

(2) Cash and Cash Equivalents and Investments (continued)

The restricted cash and investments are comprised of the following funds as of June 30, 2013 and 2012:

Maryland Environmental Service:

	(In Thousands)	
	2013	2012
Trustee held:		
Rebate Funds	\$ -	\$ 40
Service held:		
Project restricted	345	359
	<u>\$ 345</u>	<u>\$ 399</u>

Midshore Regional Landfill:

	(In Thousands)	
	2013	2012
Trustee held:		
Interest	\$ 4	\$ 4
Closure Fund	759	759
Construction Funds	559	774
Service held:		
Liability Fund	822	822
	<u>\$ 2,144</u>	<u>\$ 2,359</u>

Maryland Environmental Service
Notes to Financial Statements
June 30, 2013 and 2012
(In thousands except where noted)

(2) Cash and Cash Equivalents and Investments (continued)

OPEB Trust:

All investments are valued at fair value. Fair value for investments is determined using quoted market value of securities. Assets held in trust are held in a custodial account for which the custodian makes no investment decisions. PNC Institutional Investments is the advisor that provides investment management services.

The Service follows the asset allocation policy adopted by the State of Maryland for the Post-Retirement Health Benefits Trust.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The plan's investment policy does not limit investment maturities as a means of managing its exposure to fair value losses arising from increases interest rates.

For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Plan would not be able to recover the value of its investments that are in the possession of an outside party. Investment securities are exposed to custodial risk if the securities are uninsured, are not registered in the name of the Plan, and are held by either (a) the counterparty or (b) the counterparty's trust department or agent but not in the Plan's name. Investments of \$1,527,496 are uncollateralized and exposed to credit risk as of June 30, 2013.

Concentration of credit risk is the risk of loss attributed to the magnitude of the Plan's investment in the securities of a single issuer. As of June 30, 2013, the Plan had the following investments, which represented 5% or more of total investments:

Issue	Fair Value	Percentage
Vanguard Total Stock Market ETF	\$ 346,139	23%
DWS Sector TR	77,274	5
Dodge & Cox International Stock Fund	359,072	24
iShares MSCI EAFE Index Fund	336,122	22
Vanguard Total Bond Index Fund	204,825	13
T Rowe Price Real Estate Fund	73,387	5

Maryland Environmental Service
Notes to Financial Statements
June 30, 2013 and 2012
(In thousands except where noted)

(3) Net Investment in Direct Financing Leases (In Thousands)

The components of the net investment in direct financing leases as of June 30, 2012 are presented below.

	2012
Minimum lease payments receivable	\$ 10
Less – unearned income	-
	10
Less – restricted investments related to unexpended bond proceeds	-
Net investment in direct financing leases	<u>\$ 10</u>
Current	\$ 10
Non- current	-
Net investment in direct financing leases	<u>\$ 10</u>

As of June 30, 2013, all lease payments have been received, and there are no amounts due.

Maryland Environmental Service
Notes to Financial Statements
June 30, 2013 and 2012
(In thousands except where noted)

(4) Capital Assets (In Thousands)

The tables below represent the changes in capital assets for the years ended June 30, 2013 and 2012:

Maryland Environmental Service:

2013	Balance 06/30/12	Additions	Deletions	Transfers In/Out	Balance 06/30/13
Capital assets, not depreciated					
Land and improvements	\$ 1,223	\$ -	\$ (183)	\$ -	\$ 1,040
Capital assets, being depreciated					
Structures and improvements	30,900		(490)	-	30,410
Equipment	14,452	1,748	(528)	-	15,672
Total capital assets being depreciated	<u>45,352</u>	<u>1,748</u>	<u>(1,018)</u>	<u>-</u>	<u>46,082</u>
Less: accumulated depreciation for					
Structures and improvements	21,686	474	(406)	-	21,754
Equipment	9,114	1,258	(470)	-	9,902
Total accumulated depreciation	<u>30,800</u>	<u>1,732</u>	<u>(876)</u>	<u>-</u>	<u>31,656</u>
Total capital assets, net	<u>\$ 15,775</u>	<u>\$ 16</u>	<u>\$ (325)</u>	<u>\$ -</u>	<u>\$ 15,466</u>
2012	Balance 06/30/11	Additions	Deletions	Transfers In/Out	Balance 06/30/12
Capital assets, not depreciated					
Land and improvements	\$ 1,223	\$ -	\$ -	\$ -	\$ 1,223
Capital assets, being depreciated					
Structures and improvements	30,830	70	-	-	30,900
Equipment	12,688	2,835	(1,071)	-	14,452
Total capital assets being depreciated	<u>43,518</u>	<u>2,905</u>	<u>(1,071)</u>	<u>-</u>	<u>45,352</u>
Less: accumulated depreciation for					
Structures and improvements	21,634	52	-	-	21,686
Equipment	8,490	1,650	(1,026)	-	9,114
Total accumulated depreciation	<u>30,124</u>	<u>1,702</u>	<u>(1,026)</u>	<u>-</u>	<u>30,800</u>
Total capital assets, net	<u>\$ 14,617</u>	<u>\$ 1,203</u>	<u>\$ (45)</u>	<u>\$ -</u>	<u>\$ 15,775</u>

Maryland Environmental Service
Notes to Financial Statements
June 30, 2013 and 2012
(In thousands except where noted)

(4) Capital Assets (In Thousands) (continued)

Midshore Regional Landfill:

	06/30/12	Additions	Deletions	In/Out	06/30/13
Capital assets, not depreciated					
Land and improvements	\$ 1,690	\$ -	\$ -	\$ -	\$ 1,690
Construction in progress	-	174	-	-	174
Total capital assets, not depreciated	<u>1,690</u>	<u>174</u>			<u>1,864</u>
Capital assets, being depreciated					
Structures and improvements	33,423	4	(25)	-	33,402
Equipment	4,992	10	-	-	5,002
Total capital assets being depreciated	<u>38,415</u>	<u>14</u>	<u>(25)</u>	<u>-</u>	<u>38,404</u>
Less: accumulated depreciation for					
Structures and improvements	14,953	523	(25)	-	15,451
Equipment	3,680	522	-	-	4,202
Total accumulated depreciation	<u>18,633</u>	<u>1,045</u>	<u>(25)</u>	<u>-</u>	<u>19,653</u>
Total capital assets, net	<u>\$ 21,472</u>	<u>\$ (857)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 20,615</u>
2012	Balance			Transfers	Balance
	06/30/11	Additions	Deletions	In/Out	06/30/12
Capital assets, not depreciated					
Land and improvements	\$ 1,690	\$ -	\$ -	\$ -	\$ 1,690
Capital assets, being depreciated					
Structures and improvements	33,185	238	-	-	33,423
Equipment	4,834	380	(297)	75	4,992
Total capital assets being depreciated	<u>38,019</u>	<u>618</u>	<u>(297)</u>	<u>75</u>	<u>38,415</u>
Less: accumulated depreciation for					
Structures and improvements	14,430	523	-	-	14,953
Equipment	3,372	529	(221)	-	3,680
Total accumulated depreciation	<u>17,802</u>	<u>1,052</u>	<u>(221)</u>	<u>-</u>	<u>18,633</u>
Total capital assets, net	<u>\$ 21,907</u>	<u>\$ (434)</u>	<u>\$ (76)</u>	<u>\$ 75</u>	<u>\$ 21,472</u>

Maryland Environmental Service
Notes to Financial Statements
June 30, 2013 and 2012
(In thousands except where noted)

(5) Construction Commitments

There were no new construction commitments outstanding as of June 30, 2013.

(6) Concentrations of Credit

The Service derived approximately 59% and 63% of its revenue and had approximately 34% and 53% of accounts receivable outstanding in 2013 and 2012, respectively, from providing services to the State of Maryland.

(7) Leases (In Thousands)

Operating Leases

The Service leases office, warehouse, and parking space under operating leases, which expire over the next twenty years.

Rent expense for operating leases was \$35 and \$34 thousand for the years ended June 30, 2013 and 2012 respectively.

Capital Leases

The Service has entered into several leases for financing the building, furniture, fixtures and equipment used in administration and project operations. These lease agreements qualify as capital leases for accounting purposes, therefore, have been recorded at the present value of their future minimum lease payments as of the inception date.

Maryland Environmental Service
Notes to Financial Statements
June 30, 2013 and 2012
(In thousands except where noted)

(7) Leases (In Thousands) (continued)

The future minimum lease obligations from capital leases and the net present value of these minimum lease payments as of June 30, 2013, were as follows:

<u>Years ending June 30:</u>	
2014	\$ 842
2015	842
2016	842
2017	842
2018	842
2019-2023	3,099
2024-2025	<u>550</u>
Total minimum lease payments	7,859
Less: amount representing interest	<u>(1,822)</u>
Present value of minimum lease payments	6,037
Less: current portion	(523)
Long-term portion of capital leases	<u><u>\$ 5,514</u></u>

Certain assets acquired using capital leases are held in custody for various customers. Accordingly, such assets are not capitalized by the Service.

Maryland Environmental Service
Notes to Financial Statements
June 30, 2013 and 2012
(In thousands except where noted)

(8) Debt (In Thousands)

Long-term debt (including current portion) consists of the following as of June 30:

Maryland Environmental Service:

	2013	2012
Bank of America- General Obligation Bond		
\$392 and \$428 as of June 30, 2013 and 2012, respectively. Interest at 4.05% and principal due in quarterly installments of \$18 through March 31, 2022.	\$ 392	\$ 428
	392	428
Less: current portion	38	36
Long-term portion of debt	\$ 354	\$ 392

Maryland Environmental Service
Notes to Financial Statements
June 30, 2013 and 2012
(In thousands except where noted)

(8) Debt (In Thousands) (continued)

Future minimum payments for long-term debt at June 30, 2013, were due as follows:

(In Thousands)	<u>Total</u>	<u>Principal</u>	<u>Interest</u>
Years ending June 30:			
2014	\$ 53	\$ 38	\$ 15
2015	53	40	13
2016	53	41	12
2017	53	43	10
2018	53	45	8
2019-2022	<u>200</u>	<u>185</u>	<u>15</u>
	<u>\$ 465</u>	<u>\$ 392</u>	<u>\$ 73</u>

The Landfill Project Revenue Bonds, 1993 Series, were issued in connection with the acquisition and construction of a sanitary landfill facility in Garrett County and the closure of an existing landfill facility. Garrett County leased the site of the landfill to the Service for a term equal to the term of the bonds and will pay the Service a service fee to cover the costs of financing and operating the landfill, including payment of principal and interest on the bonds. The bonds constitute special obligations of the Service payable solely from revenue from the landfill.

Maryland Environmental Service
Notes to Financial Statements
June 30, 2013 and 2012
(In thousands except where noted)

(8) Debt (In Thousands) (continued)

The General Obligation Bond of 2007 was issued to finance the acquisition of property associated with a project in Talbot County. Costs associated with carrying and maintaining the property will be charged to the project, however the debt is payable from Agency resources.

The Master Equipment Lease Purchase Agreements with financing institutions are used to finance the purchase of equipment used to build and operate various project facilities. The Service charges for the use of the construction and operating equipment and the revenues received are used to retire the associated debt and to purchase additional equipment. Substantially, all assets under the agreements serve as collateral under such agreements.

The various trust indentures stipulate that the value of the assets in the debt service reserve funds (recorded as restricted cash or investments) meet the related debt service reserve fund requirements. As of June 30, 2013, such debt service reserve requirements were met, and management believes the Service is in compliance with all other significant requirements of the indentures.

Midshore Regional Landfill:

Hobbs Road Landfill Closure Project Water Quality Bond, Series 2011A; April 2011

\$1,752; interest at 1.1% paid semiannually in February and August; due in annual installments beginning 2013 through 2031 in varying amounts from \$90 to \$111.	1,752
	19,325
Total	19,325
Less: current portion	732
	18,593
Long-term portion of debt	\$ 18,593

Maryland Environmental Service
Notes to Financial Statements
June 30, 2013 and 2012
(In thousands except where noted)

(8) Debt (In Thousands) (continued)

Midshore Regional Landfill:

Future minimum payments for long-term debt as of June 30, 2013, were due as follows:

(In Thousands)

Years ending June 30:	<u>Total</u>	<u>Principal</u>	<u>Interest</u>
2014	\$ 1,535	\$ 732	\$ 803
2015	1,530	748	782
2016	1,532	774	758
2017	1,533	805	728
2018	1,534	836	698
2019-2023	7,666	4,741	2,925
2024-2028	7,557	5,949	1,608
2029-2031	<u>7,267</u>	<u>4,222</u>	<u>3,045</u>
	30,154	18,807	11,347
Plus: Unamortized bond premium	<u>518</u>	<u>518</u>	<u>-</u>
Total	<u>\$ 30,672</u>	<u>\$ 19,325</u>	<u>\$ 11,347</u>

The Regional Landfill Project Revenue Bonds, 2011 Series, were issued in connection with the construction of the Mid-shore II Landfill Facility. The bonds constitute special obligations of the Service and are payable solely from revenues (tipping fees and supplemental fees) from the project pledged by the Service under the bond indentures. Neither the State of Maryland, nor any political subdivision, nor the Service shall be obligated to pay the bonds or the interest thereon, except from such project revenue. In the event of any participating county's failure to pay any amounts required under the related Waste Service Agreement when due, the Service may accept Acceptable Waste generated outside the Mid-shore Counties. In addition, the State Intercept Provision Section 3-108(b) provides that if a Mid-shore fails to pay the Service within 60 days of the due date as established by contract, all State funds, or that portion of them required, relating to the income tax, the tax on racing, the recordation tax, the tax on amusements and the license tax which would otherwise be distributed to such Mid-shore County by the Comptroller of Maryland shall be paid directly to the Service.

The Maryland Environmental Service Water Quality Bond, Series 2011A, was issued in connection with the closure and capping of the Hobbs Road Landfill. The bond constitutes special obligations of the Service and are payable solely from revenues (tipping fees and supplemental fees) from the project pledged by the Service under the bond indentures. Neither the State of Maryland, nor any political subdivision, nor the Service shall be obligated to pay the bonds or the interest thereon, except from such project revenue. In the event of any participating county's failure to pay any amounts required under the related Waste Service Agreement when due, the Service may accept Acceptable Waste generated outside the Mid-shore Counties. In addition, the State Intercept Provision Section 3-108(b) provides that if a Mid-shore fails to pay the Service within 60 days of the due date as established by contract, all State funds, or that portion of them required, relating to the income tax, the tax on racing, the recordation tax, the tax on amusements and the license tax which would otherwise be distributed to such Mid-shore County by the Comptroller of Maryland shall be paid directly to the Service.

Maryland Environmental Service
Notes to Financial Statements
June 30, 2013 and 2012
(In thousands except where noted)

(8) Debt (In Thousands) (continued)

The following table represents changes in long-term liabilities for the years ended June 30, 2013 and 2012 (in thousands):

Maryland Environmental Service:

2013	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Advances from project participants	\$ 24,628	\$ 42,077	\$ (32,019)	\$ 34,686	\$ 33,868
Capitalized leases	6,813	-	(775)	6,038	523
Long-term debt	428	-	(36)	392	38
Workers' compensation	2,642	83	-	2,725	422
Long-term liabilities	<u>\$ 34,511</u>	<u>\$ 42,160</u>	<u>\$ (32,830)</u>	<u>\$ 43,841</u>	<u>\$ 34,851</u>

2012	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Advances from project participants	\$ 22,424	\$ 26,438	\$ (24,234)	\$ 24,628	\$ 22,872
Capitalized leases	8,055	-	(1,242)	6,813	776
Long-term debt	1,822	-	(1,394)	428	36
Workers' compensation	2,404	238	-	2,642	410
Long-term liabilities	<u>\$ 34,705</u>	<u>\$ 26,676</u>	<u>\$ (26,870)</u>	<u>\$ 34,511</u>	<u>\$ 24,094</u>

Midshore Regional Landfill :

2013	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Capitalized leases	\$ 234	\$ -	\$ (234)	\$ -	\$ -
Long-term debt	20,040	-	(715)	19,325	732
Landfill closure & post closure care	9,646	327	(181)	9,792	-
Long-term liabilities	<u>\$ 29,920</u>	<u>\$ 327</u>	<u>\$ (1,130)</u>	<u>\$ 29,117</u>	<u>\$ 732</u>

2012	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Capitalized leases	\$ 484	\$ -	\$ (250)	\$ 234	\$ 234
Long-term debt	20,791	6	(757)	20,040	711
Landfill closure & post closure care	9,187	1,037	(578)	9,646	-
Long-term liabilities	<u>\$ 30,462</u>	<u>\$ 1,043</u>	<u>\$ (1,585)</u>	<u>\$ 29,920</u>	<u>\$ 945</u>

Maryland Environmental Service
Notes to Financial Statements
June 30, 2013 and 2012
(In thousands except where noted)

(9) Unrestricted Net Position

Total unrestricted net position as of June 30, 2013 and 2012, were as of follows:

	2013	2012
Total unrestricted net position	\$ 10,552	\$ 10,561

(a) Business Research and Development/Contingency

The Service has dedicated funds for the furtherance of its program development activities. These uses may include, but are not limited to: developing, supporting, researching, promoting, securing, providing and procuring goods and services for new and proposed projects, experiments, programs and facilities. Additionally, these funds are available for project contingencies.

(b) Equipment

The Service has dedicated funds to facilitate procurement and maintenance of equipment for itself and its clients. The Service charges the appropriate projects for the usage of equipment procured from this reserve and accumulates the costs applicable to that equipment. The operating results of this fund have been restricted for the future use of the fund.

(10) Accrued Workers' Compensation Costs

The accrued workers' compensation costs, applicable to the Service's coverage discussed in note 14, are recorded as a short-term and long-term liability. As these costs are recoverable under the Service's contracts, a receivable from project participants has been recorded to reflect the future funding of this liability.

(11) Pension

Employees of the Service who were members of the State Employees Retirement or Pension systems on June 30, 1993, continue to participate in the Employees' Retirement and Pension Systems. These systems are part of the Maryland State Retirement and Pension System (System), and are cost-sharing multiple employer public employee retirement systems. The System, which is administered in accordance with the State Personnel and Pensions Article of the Annotated Code of Maryland, consists of several plans, which are managed by the Board of Trustees for the system. The System provides retirement, death and disability benefits in accordance with State statutes. Vesting begins after completion of five years of service. Members of the Retirement System may retire with full benefits after attaining the age of 60, or completing 30 years of Service Credit, regardless of age. Members of the Pension system may retire with full benefits after attaining the age of 62 or after completing 30 years of Service Credit, regardless of age. The State Employees Retirement and Pension System prepares a separately audited

Maryland Environmental Service
Notes to Financial Statements
June 30, 2013 and 2012
(In thousands except where noted)

(11) Pension (continued)

Comprehensive Annual Financial Report, which can be obtained from the State Retirement and Pension System of Maryland, 120 E. Baltimore Street, Baltimore, Maryland 21202.

Members of the Retirement System are required to contribute to the System either 7% or 5% of their regular salaries and wages depending upon the retirement option selected. Members of the Contributory Pension System are required to contribute to the System 5% of their regular salaries and wages. Employer contribution rates are determined by the State annually. The Service's share of the cost of participation was \$237 thousand and \$258 thousand, for the years ended June 30, 2013 and 2012, respectively.

All other employees of the Service participate in a Vanguard 401(k) Savings Plan. The plan requires the Service to contribute to the fund. The Service's share of the cost of participation for the years ended June 30, 2013 and 2012 were \$2,214 thousand and \$2,249 thousand, respectively. Employees are fully vested when eligible for the plan.

(12) Contingent Liabilities

The Service is involved in litigation arising from the normal course of its operations. In the opinion of management, the amount of liability, if any, resulting from the final resolution of these matters will not be material to the financial position of the Service.

On April 15, 2011, the Maryland Environmental Service issued \$1.5 million of Water Quality Bond, Series 2011B with the Maryland Water Quality Financing Administration (the Administration) in connection with the closure and capping of the Hobbs Road Landfill. Pursuant to the Clean Water Act, the Administration has forgiven the repayment of the principal amount and interest payment of the bond subject to MES continues to perform its other obligations under the agreement. Upon determination by the Administration that any of the other obligations under the agreement have been violated, payment of the principal and interest will be become due and payable on demand. As of June 30, 2012, management believes it is in compliance with its obligations and has not violated the agreement. The loan forgiveness has been recognized as capital grant income in the accompanying statement of changes in net position for the year ended June 30, 2012.

(13) Landfill Closure and Postclosure Care Costs

State and Federal laws require the Service to cover and to perform certain maintenance and monitoring functions at Midshore I, Easton Landfill, Midshore II and Hobbs Road Landfill sites for 30 years after closure. Although closure and postclosure care costs will be paid near or after the date the landfills stop accepting waste, the Service reports apportionment of these closure and post closure costs as a liability based upon the estimated useful life of the landfills.

Midshore I current cells are approximately 93% filled as of June 30, 2013. The landfill stopped accepting waste on December 31, 2010. Total closure and postclosure care costs for the landfill is currently estimated to be \$10,831 thousand, as determined through engineering studies and \$8,762 thousand and \$8,943 thousand has been recognized as a liability by the Service as of June 30, 2013 and 2012, respectively.

Midshore II current cells are approximately 7% filled as of June 30, 2013, with a remaining life of 36 years. Total closure and postclosure care costs for the landfill is currently estimated to be \$17,591 thousand, as determined through engineering studies, and \$1,030 thousand and \$703 thousand has been recognized as a liability by the Service as of June 30, 2013 and 2012, respectively. Costs may be subject to change due to inflation, deflation, technology, and changes in applicable laws and regulations.

Maryland Environmental Service
Notes to Financial Statements
June 30, 2013 and 2012
(In thousands except where noted)

(13) Landfill Closure and Postclosure Care Costs (continued)

Under Federal regulations, the Service satisfied its financial assurance requirements based upon local government financial ratio tests of the project participants as of June 30, 2012. The Service expects to satisfy these requirements as of June 30, 2013 using the same criteria.

The Service as an operator for various landfills throughout the State of Maryland and no liability is recognized in regards to landfill closure and postclosure costs related to these landfills because of the Service's limited role solely as an operator of these facilities.

(14) Risk Management

The Service is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Service participates in the State of Maryland's self-insurance program (the program). The program covers general liability, property and casualty, workers' compensation (see note 10), and environmental liabilities, and provides certain employee health benefits. The program allocates its cost of providing claims servicing and claims payments by charging a "premium" to the Service based on a percentage of estimated current payroll or based on average loss experience. The Service's premium for the years ended June 30, 2013 and 2012 were \$4,247 thousand and \$5,174 thousand, respectively.

**Maryland Environmental Service
Required Supplemental Information for Other Postemployment Benefit Plan
June 30, 2013**

**Schedule of Funding Progress (1)
Other Post Employment Benefits
(In Thousands)**

<u>Valuation Date</u>	<u>Value of Assets</u>	<u>Accrued Liability (AAL)</u>	<u>Unfunded AAL (UAAL)</u>	<u>Funded Ratio</u>	<u>Covered Payroll</u>	<u>UAAL as a % of Covered Payroll</u>
July 1, 2011	\$ 1,111	\$ 2,995	\$ 1,884	37%	\$ 32,615	5.8%
July 1, 2009	\$ -	3,015	3,015	-	34,152	8.8%

(1) The Service has chosen to have actuarial valuations performed bi-annually for purposes of calculating the actuarial accrued liability as allowed by GASB Statement No. 45.

<u>Years Ended</u>	<u>Annual Required Contribution</u>	<u>Percentage Contributed</u>
2013	\$288	128%
2012	\$225	120%
2011	\$313	100%



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**REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS 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***

To the Board of Directors
Maryland Environmental Services

We have audited, 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, the financial statements of the business type activities and fiduciary funds of the Maryland Environmental Service (the Service), a component unit of the State of Maryland, as of and for the years ended June 30, 2013 and 2012, and the related notes to the financial statements, which collectively comprise the Service's basic financial statements, and have issued our report thereon dated September 30, 2013.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Service'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 opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Service's internal control. Accordingly, we do not express an opinion on the effectiveness of the Service'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 over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control over financial reporting 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 Service'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*.

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.

Hunt Valley, Maryland
September 30, 2013

SB & Company, LLC