

2011 ANNUAL REPORT



MARTIN O'MALLEY
GOVERNOR OF MARYLAND

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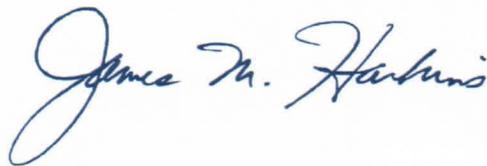
Director's Letter

As we entered fiscal year 2011, the economy continued to create challenges for our customers. State, local and municipal governments faced shrinking budgets and an increased demand for improved environmental performance. In response, MES looked to strengthen our core services by providing financial flexibility and performing at high customer service levels. Our team of professionals remained committed to providing low-cost solutions to environmental issues.

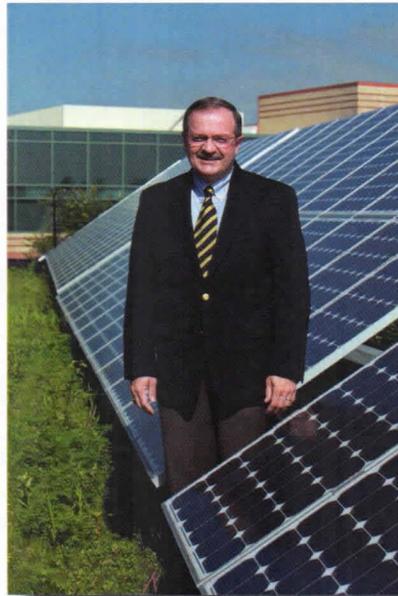
MES financial results proved to be solid for the year. Although operating revenues declined 9% as a result of completed construction projects in 2010, net assets increased \$579,000. In difficult economic times, our Agency remains strong, nimble, and ready to serve our customers.

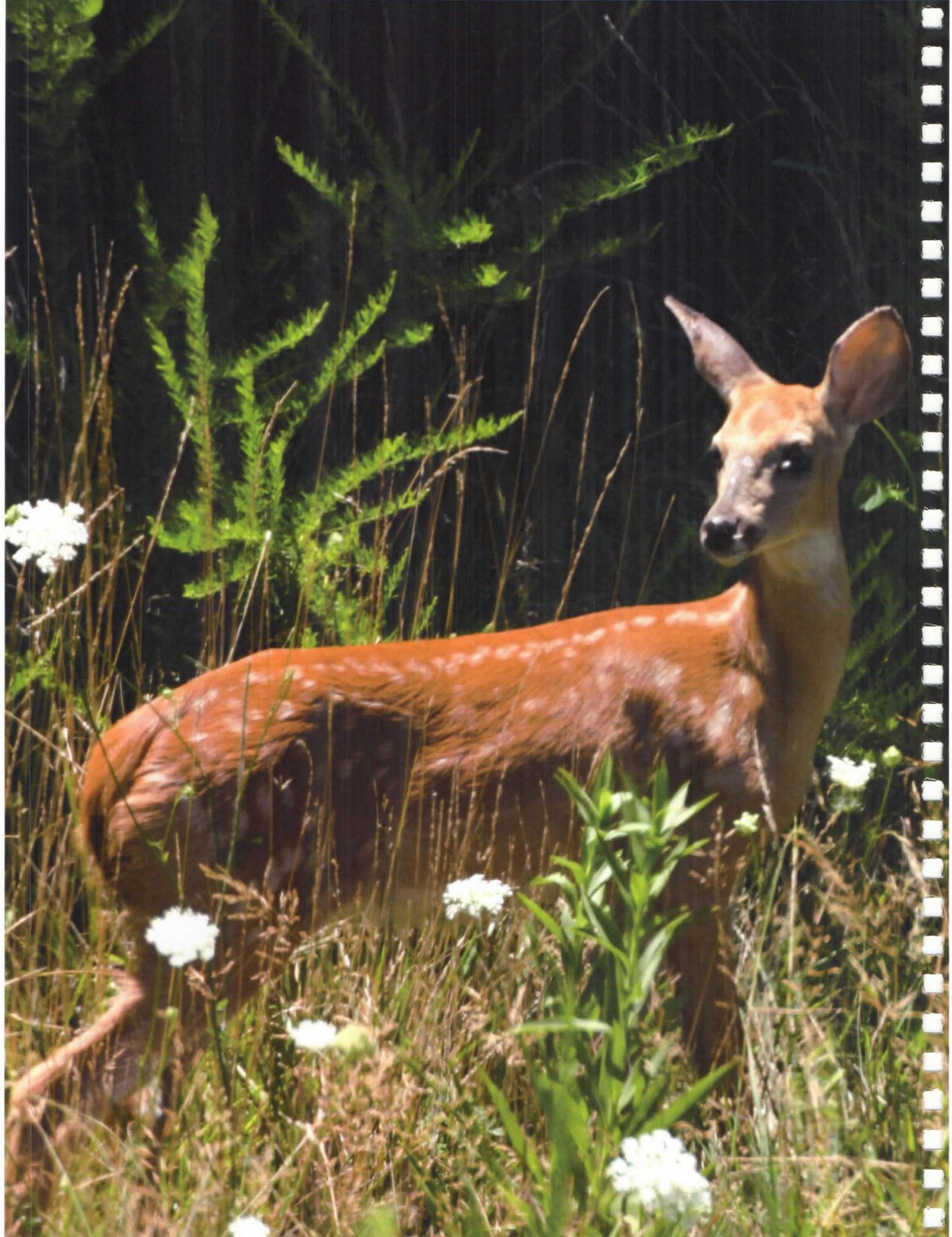
At our Millersville headquarters, we celebrated our designation as LEED Gold Certified. Our building is Maryland's first state government building with operations and maintenance practices certified to LEED standards – the rating system that measures the success and impact of a building's sustainability efforts.

The LEED designation symbolizes our agency-wide commitment to progress and innovation. The people of Maryland deserve and demand the highest standards of environmental safety. Our goal, as always, is to help our clients meet those standards, and protect our land, air, and water for generations to come.



James M. Harkins
Director





WHO WE ARE

In 1970, Maryland's Governor and legislators created Maryland Environmental Service to protect the state's air, land and water resources. Today, our independent State agency continues to fulfill this vital directive.

We have no regulatory authority and we receive no direct appropriations. Our agency is a self-supporting, not-for-profit public corporation, combining the public sector's commitment to environmental protection with the private sector's flexibility and responsiveness.

MES provides services at competitive rates to government and private sector clients and works on projects including water and wastewater treatment, solid waste management, composting, recycling, dredged material management, hazardous materials cleanup, and renewable energy. We provide expert engineering, monitoring and inspection services.

With 780 diverse projects located in three states, ranging in cost from \$300 to \$6.4 million, we couple operational expertise with a commitment to strict environmental compliance and safe work practices.

Today, Maryland Environmental Service remains focused on finding innovative solutions to our region's most complex environmental challenges and preserving our region's natural resources for generations to come.

MISSION

To provide operational and technical services to protect and enhance the environment for the people of Maryland.

VISION

Maryland Environmental Service: an innovative and leading edge solver of environmental problems; a responsible and successful manager of environmental operations; and a great place to work.



The LEED Program - Leadership in Energy and Environmental Design - emphasizes state-of-the-art strategies for sustainable site development, water savings, energy efficiency, materials selection and indoor environmental quality. As part of our commitment to the environment, MES chose the LEED criteria as the guideline for construction of our headquarters.

The building was designed to fully integrate the structure and site. This integration of built and natural environments was accomplished using bioswales, rooftop rainwater for landscape irrigation, and xeriscape landscape practices. Our headquarters boasts a wide range of sustainable features that include commercially available materials and technologies to maximize energy and water conservation. In 2010, parking was expanded using permeable pavers.

In 2008, MES partnered with Constellation Energy to host a grid-connected solar power facility. The project includes over 1,500 crystalline photovoltaic solar cell panels adjacent to the building and flexible thin panels attached to the building's rooftop. The solar array generates the equivalent of 50 percent of our building's energy needs from renewable sources.



In 2011, the U.S. Green Building Council designated the MES Headquarters Building as LEED Gold certified. MES HQ also is Maryland's first state government building with operations and maintenance practices certified to LEED standards.



Volunteer grass planting on Poplar; Students release young diamondback terrapins

HART-MILLER ISLAND

MES has operated and maintained Hart-Miller Island, an 1,140-acre dredged material containment facility since 1984. There, a project that began in controversy has become a model of successful collaboration between government and citizens. Through careful engineering, Hart-Miller Island now serves as both a valuable habitat for vast numbers of shore and water birds, and an outstanding recreational site for boaters. The last placement of dredged material at HMI took place in 2009. MES will continue to provide support to the project with closure and habitat development of the Island's North Cell.

COX CREEK

MES operates the 133-acre Cox Creek Dredged Material Containment Facility for the Maryland Port Administration. Starting in 2010, Cox Creek and Masonville became the remaining two options for placement of Harbor dredged material. In 2011, MES continued to work with MPA to implement pilot projects for the innovative reuse of dredged material, which will gain importance as placement facilities are filled. Cox Creek is the potential

future home of innovative reuse activities for MPA. MES also manages the Swan Creek wetlands adjacent to Cox Creek. This wetland is an 11.13-acre habitat restoration project that created vegetated wetlands, shallow water and a special cobble riffle for fish passage.

This restored area has become an urban habitat for wildlife, including ibis, heron, eagles and waterfowl. Submerged aquatic vegetation has colonized the area, and increased fish diversity has also been found in the area where MES installed 143 reef balls, an artificial marine habitat built from concrete.

MASONVILLE

MES continued management of the \$153 million Masonville Cove construction and restoration project for the Port of Baltimore. MES completed exterior dike construction for the Masonville Dredged Material Containment Facility in 2010, and should complete land side dike construction in 2011. Masonville is a 141-acre facility, with 130 acres of open water contained by sand dikes armored with rock or bordered with fringe wetlands.



Masonville Dredged Material Containment Facility



The Md. Port Administration and the Masonville Project Development Team received a Coastal American Special Recognition Award for their outstanding efforts to restore and protect the coastal environment.

The award emphasizes the significance of the Masonville Project restoration and stewardship accomplishments, recognizing the team's efforts to improve community access to Masonville Cove and to improve recreation and environmental education opportunities in the Brooklyn-Curtis Bay area. "The Masonville Project Team's effort exemplifies a holistic aquatic ecosystem approach to sustainable restoration, public education and outreach," said Virginia Tippie, Coastal America's Director.

MES manages the Masonville Cove construction and restoration project for the Maryland Port Administration and is part of the project development team. As part of the construction project permitting, MES is managing design and constructing mitigation elements of the project, including enhancement of the Masonville Cove area next to the new placement facility.

The Coastal America Partnership is dedicated to restoring and preserving coastal ecosystems and addressing critical environmental issues.

As part of the construction project permitting, MES is designing and constructing mitigation elements of the project, including enhancement of the Masonville Cove area next to the new placement facility, with wetlands, sand beaches, improved reef habitat, a community education center, a bird sanctuary, and walking trails. Local residents will have access to the Patapsco River at Masonville Cove and a boat ramp for kayaks and canoes.

At the Masonville Cove Environmental Education Center, educational and environmental programs enrich the community. The center is a near-zero net-energy building, uses a ground source HVAC system and solar energy power. The center, constructed by MES, was built green, incorporating features such as fresh air energy recovery, recyclable materials, and efficient building standards with minimal energy input.

The Baybrook community organization, Living Classrooms Foundation and the National Aquarium in Baltimore conduct the education programs for the center.





Restoring Poplar Island with dredged materials



TECHNICAL AND ENVIRONMENTAL SERVICES

ENVIRONMENTAL DREDGING AND RESTORATION

The Environmental Dredging and Restoration Division provides services in the field of dredged material management with an emphasis on planning, operation of dredged material placement sites, environmental restoration and use of dredged material as a natural resource. The division also provides environmental support to the Maryland Department of Natural Resources Fisheries Service, Boating Service, Watershed Service and Forest Service.

POPLAR ISLAND

MES operates the Paul S. Sarbanes Ecosystem Restoration Project at Poplar Island for the Maryland Port Administration and their Federal partner, the U.S. Army Corps of Engineers. Once a 1,000-plus acre island with a thriving community, the island slowly eroded away, leaving only three tiny remnants. Today, clean dredged materials are being used to rebuild the island and its upland and wetland habitats. In addition to providing millions of cubic yards of dredged material placement capacity, Poplar

Island is now recognized as a valuable nesting and nursery area for many species of wildlife, including eagles, osprey, heron and diamondback terrapins.

In 2011, the Poplar Island Restoration Project continued the filling and wetland construction phase. An expansion of Poplar Island is still in the design phase. Upon completion, the expanded Talbot County ecosystem restoration project will be approximately 1,715 acres in size, with 737 acres of wetland, 840 acres of upland and 138 acres of open-water embayment habitat. MES operation and maintenance at Poplar is expected to continue through at least 2028.

MES works directly with eastern shore schools through the TERP Program (Terrapin Education and Research on Poplar) to raise diamondback terrapins in classrooms. In the 2010-2011 school year, 15 teachers from 10 schools raised 30 terrapins. In spring 2011, 220 terrapins raised through Arlington Echo, the National Aquarium, and MES' TERP program were released on Poplar Island.

During the 2010-2011 school year, 6,994 Maryland students learned about the Port of Baltimore, the importance of dredging, and MES/MPA/USACE environmental restoration work through classroom visits and events with the diamondback terrapin ambassadors.





Volunteer planting at Masonville; Masonville Cove Environmental Education Center

SPARROWS POINT

As part of MPA's planning for the next phase of dredged material management, officials have asked MES to manage the feasibility studies and environmental planning for a new dredged material containment facility at Sparrows Point in Baltimore. The site is currently not owned by MPA and these studies will help determine whether acquiring the property meets the State's needs.

The planning and feasibility studies are the initial steps for developing what MPA hopes to become the next facility in their long term plan for dredged material management. Sparrows Point would require on-site remediation in addition to the construction tasks to develop the facility, and MES will work to remain a partner with our client on this important site.

HARBOR TEAM

MPA has asked MES to assist in working with stakeholder groups to select the next set of options for placement

of dredged material. A report will be produced in 2011 and then voted on by the other committees in the State's DMMP. MES will continue to support MPA in conducting needed investigations and studies of potential future options.

DNR FISHERIES MANAGEMENT

In 2011, MES continued to assist DNR in implementing guidance for a new fisheries management program in Maryland. Under a \$4.3 million dollar MOU, MES provided 25 associated jobs in fields related to hatcheries and restoration, conservation, public outreach and marketing.

In 2011, MES also continued to assist the Boating, Forestry and Watershed services programs at DNR. This work is responsible for an additional series of MOU's worth over \$700,000 and five new DNR support jobs.



Baltimore/Washington International Thurgood Marshall Airport

ENVIRONMENTAL MONITORING

The Environmental Monitoring Division conducts program management of environmental sampling, systems operations and maintenance, process management, strategic planning, remediation, industrial hygiene including asbestos services, fuel storage tanks, stormwater management, hazardous and universal waste services, environmental management system program development, and geographical information systems (GIS) support. The Division also has contractual laboratory capabilities and performs compliance assistance and reporting, and preventative maintenance.

BALTIMORE/WASHINGTON INTERNATIONAL THURGOOD MARSHALL AIRPORT

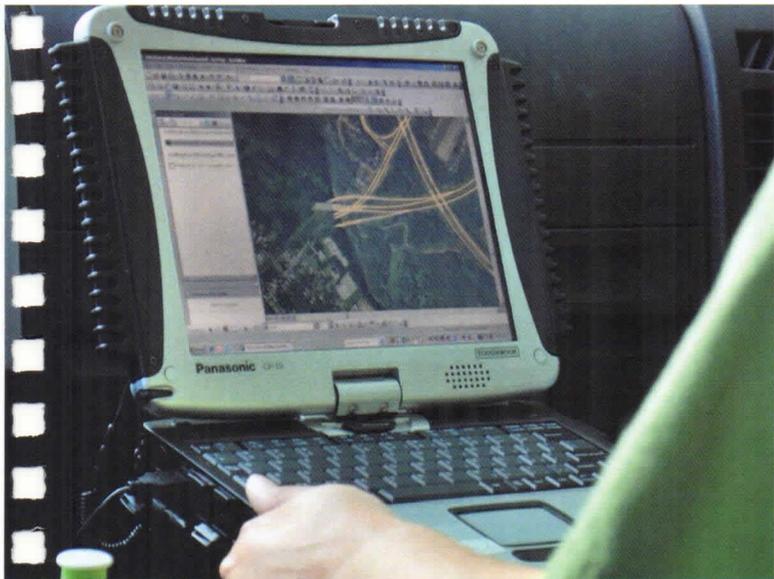
Through its collection and processing of the de-icing fluids during the winter months, MES has significantly reduced the amount of de-icing material reaching streams near BWI, achieving permit compliance each year. MES collects stream samples continuously during the deicing season to ensure Maryland Aviation Administration environmental compliance.

MES provides comprehensive infrastructure management related services including the following programs: drinking water distribution, sanitary sewer, stormwater, fuel storage and fuel cleaning, emergency response, preventive and predictive maintenance, inventory control and GIS support.

DEPARTMENT OF TRANSPORTATION (MDOT) MODALS

MES provides comprehensive program management, technical and scientific consulting, and field-based services to many MDOT modals. Services include environmental spill/leak investigations, sampling, compliance assistance, remediation, NPDES and TMDL assistance, maintenance, underground storage tank removal and inspections, above-ground storage tank installations, fueling facility upgrades, asbestos and lead paint monitoring, large stormwater programs, invasive species control, oil/water separator inspection and maintenance, and environmental management system development.

MES operates and manages the Hawkins Point Hazardous Waste Landfill, a long-standing project with the Maryland Port Administration. Services include continued routine



Geographic Information Systems thistle control work for State

leachate management and disposal as collected from the surrounding landfill. MES also provides stormwater and sediment and erosion control measures, as well as routine groundwater monitoring and sampling.

RENEWABLE ENERGY PROGRAM

MES helps with a full range of energy services including energy audits, feasibility studies, energy use footprint analyses, technology assessments, design, installation and operation of wind energy, solar, geothermal and biomass processes.

MES is the lead agency for the construction of an anaerobic digester on Maryland's Eastern Shore. This will be the first large-scale anaerobic digester in Maryland and one of the first in the country to use poultry litter as feedstock. Out of 169 anaerobic digesters in the US, only five use poultry waste. The anaerobic digester will be an important source of renewable energy and assist with nutrient management goals for the Chesapeake Bay.

In October 2010, MES and EcoCorp, the project developer, entered into a twenty year Power Purchase

Agreement (PPA), through which the State agreed to purchase power from EcoCorp. To generate the power, EcoCorp will construct a plant sized at approximately 1 MW. Per the terms of the PPA, the State will not incur any capital costs for the digester. The anaerobic digester will use approximately 5,000 tons of poultry litter per year.



Poultry litter fueled Anaerobic digester

We are helping the Maryland Energy Administration with the evaluation of Federal stimulus funding for eligible counties and municipalities across the State, energy audits for the City of College Park and managing the Residential Anemometer Program. The Anemometer program requires installation of wind gauges and analysis of data to determine feasibility for homeowners to install wind turbines on their property.



Stormwater maintenance - before and after

GEOGRAPHIC INFORMATION SYSTEM (GIS) SERVICES

MES GIS has helped State government efficiently organize, plan and implement multi-agency efforts. State Stat, MD iMap and the Government Environmental Footprint initiative have used MES GIS to help agencies to interact with each other and the public.

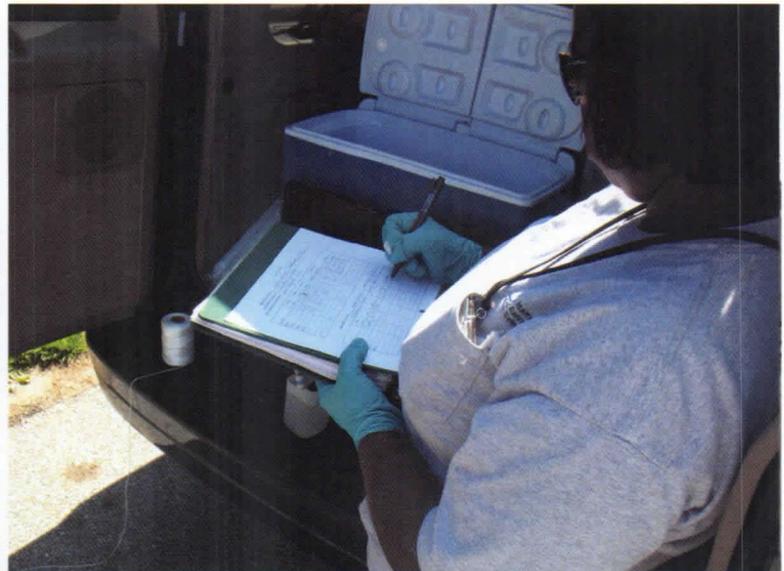
MES GIS provides important data support to the Maryland Aviation Administration, Maryland Department of the Environment, Maryland Port Administration, State Highway Administration, Motor Vehicle Administration, Maryland Energy Administration, Department of Natural Resources, Department of Business and Economic Development and the Governor's Office.

MES GIS specialists offer enhanced data collection and data sharing services, interactive mapping, application development and customized reporting.

EXPANDING WORK WITH THE MODALS

As part of its services to the MDOT modals, MES is developing and administering an expanding environmental program with MVA's Office of Environmental Management. The program covers MVA's Glen Burnie Headquarters, 17 branch locations and 18 V.E.I.P. facilities. The Service has assisted MVA's Office of Environmental Management with compliance, organization and expansion of its environmental program since 2008.

MES performs stormwater inspection and maintenance services at MVA and MDTA facilities across the State. MES inspects stormwater features at each client facility and then performs the required maintenance, ranging from vegetation control and grading to the installation of required stormwater structures. MES has also created stormwater inventory maps of several MVA facilities using GIS technology.



Sampling services

Additionally, MES has been an integral part to the success of the extensive stormwater program at the MDTA. MES has been involved since its inception, from inspections and the creation of Best Management Practices (BMPs) to rehabilitation, traffic control and corrective actions.

CFEMS

MES has been assisting MVA with the development and implementation of its Compliance-Focused Environmental Management System (CFEMS) since mid-2008. This work has included the ongoing development of a CFEMS manual for MVA and fulfilling the required elements of the CFEMS. MES has created Environmental Operating Procedures, training materials and handbooks for MVA employees and contractors. Additionally, MES has performed a gap Analysis which has directly led to expansive compliance assistance and field-based operations efforts.

REGULATORY & PERMIT OVERSIGHT

MES works to ensure that our clients are meeting all of their environmental regulatory requirements. MES staff

has developed an Asbestos Management Plan, a Spill Prevention Control & Countermeasure (SPCC) Plan for MVA's Glen Burnie site and worked with clients to obtain their Municipal Separate Storm Sewer System (MS4) general permit.

In addition, MES has executed MS4 best management practices including stenciling of storm drains leading to the Chesapeake Bay and developing and implementing MVA's illicit discharge, detection and elimination (IDDE) program. Because of the MVA's growing needs, MES is also developing MVA's Stormwater Pollution Prevention Plan.

CONSTRUCTION

MES is overseeing the design and construction of several client facilities to include a vehicle wash rack at MVA's Glen Burnie facility, as well as dozens of stormwater facilities/structures for the MDTA. As part of any renovation efforts at MVA and MDTA, MES has assisted with the management of asbestos containing materials.



Maryland Correctional Institution, Hagerstown

WATER AND WASTEWATER

At parks, hospitals, prisons and other institutions, MES serves as water and wastewater operator for the State of Maryland. We operate and maintain 138 private, municipal, and county plants; several shared-use facilities as well as 88 state-owned plants at correctional facilities, health facilities, rest areas, and State parks. Throughout the state, we correct problems at treatment facilities at the direction of the Maryland Department of the Environment.

In parts of Maryland outside of incorporated areas served by public water and sewer, MES provides high quality drinking water and wastewater treatment to protect the public health and the environment.

We use our resources to work with local health departments, school systems and utility providers to insure that new small-scale treatment systems meet modern treatment requirements and have qualified operators.

With years of experience in the operation of all types of facilities, we understand the administrative and technical requirements necessary to guarantee a safe water supply

and keep wastewater discharge in compliance with federal and state regulations.

ENHANCED NUTRIENT REMOVAL UPGRADES

To reduce nitrogen and phosphorus loadings to the Chesapeake Bay, MES is managing upgrades to several wastewater treatment plants to attain an Enhanced Nutrient Removal level of treatment. The following facilities are either in the planning, design or construction phase:

- Freedom District WWTP in Carroll County - in planning phase. Design to begin FY 2012;
- Maryland Correctional Institution WWTP in Hagerstown - under design;
- Eastern Correctional Institution WWTP in Somerset County: in planning phase. This upgrade is adding processes to go beyond the ENR level of treatment to meet an extremely stringent discharge permit;
- Dorsey Run WWTP - under construction. This plant was already meeting ENR standards but is more than 20 years old and needs rehabilitation to improve reliability, increase energy efficiency, and provide equipment



Dorsey Run Wastewater Treatment Plant

upgrades/replacement to ensure long term reliable performance.

The ENR upgrades will allow discharging treated wastewater with nitrogen concentrations of less than 3.0 mg/l and total phosphorus concentrations of less than 0.3 mg/l.

INFLOW AND INFILTRATION EVALUATIONS

Several years ago, the Maryland Department of the Environment recognized that Inflow and Infiltration (I/I) in sewer systems were causing WWTP compliance and performance problems. In many instances the I/I is significant enough to reduce capacity and prevent additional connections, jeopardizing smart growth initiatives. MDE asked MES to investigate and determine the extent of I/I throughout the State.

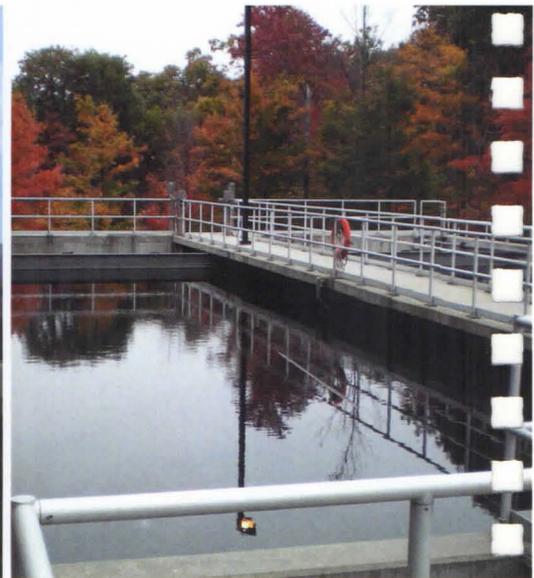
The first phase of the project was to obtain flow records and other data from 90 municipalities. This effort provided MDE with a broad-brush analysis of the extent of I/I in Maryland. Upon completion of this work, MES was asked to perform in-depth field studies of small, medium,

and large municipal sewer systems. The purpose of the in-depth evaluations was to more accurately quantify the amount of I/I, identify the sources of I/I, and what are the costs to make system improvements to reduce the amount of I/I. A total of five systems were evaluated: Cecilton, Chestertown, Thurmont, Aberdeen, and Havre de Grace.

The in-depth evaluations consisted of the following elements:

1. Review Results from Any Prior I/I Studies
2. Analyze Monthly Operating Records (MORs)
3. Gather System As-Built or Construction Drawings
4. Inventory, Inspect, and Map System
5. Develop a GIS Map of System Components
6. Perform Flow Monitoring
7. Smoke Test the System

The amount of investigation and services performed for each of the systems varied depending on what was needed and what may have already been done by the system owner/municipality. With the exception of Cecilton, none of the municipalities had accurate or complete maps of



Frostburg Water Treatment Plant

the sewer system. The first step for those municipalities was to perform an inspection and inventory the system, and use geographical information system software (GIS) to compile the inventory into a database in order to prepare a system map. The investigation of the Havre de Grace system was done toward the end of the project and the amount of funding remaining was only sufficient to perform smoke testing.

The results of the study show that I/I is a problem plaguing all systems and is only getting worse as the sewer lines get older. Addressing I/I is becoming more critical as more sophisticated WWTP treatment processes are used, because the treatment plants are even more susceptible to upsets from I/I.

Individual reports were prepared for each of the five systems evaluated. MES is currently preparing a report that will summarize the findings from the five systems and extrapolate the results statewide. The information will

assist system owners in developing their I/I assessment and improvement programs and as a planning guide to arrange funding.

BIOSOLIDS MANAGEMENT

MES Water/Wastewater staff provides technical assistance and expertise in the area of biosolids management for a number of municipalities in the State and the DC Water Blue Plains WWTP. These services include planning, development of nutrient management plans, inspections, and regulatory permitting and reporting functions on a customized basis for individual wastewater facilities.

SAVING WASTEWATER ENERGY DOLLARS

EnerNOC provides energy management services – demand response, energy efficiency, and energy procurement to 4,000 commercial, industrial and institutional energy users across North America.



Cambridge Wastewater Treatment Plant

MES arranged for the Freedom Wastewater Treatment Plant in Carroll County to participate in EnerNOC's demand response program. As a program participant, the Freedom plant earns capacity payments for being on call to respond when demand response events occur, and earns energy payments when they actually respond to an event. In the case of the wastewater treatment plant, Freedom could be called upon to temporarily run their back-up generator.

Payments are received quarterly, even if there are no events and the generators are not used. MES makes our wastewater clients aware of this program and its potential cost-savings. Perryville, Cambridge, La Plata, Frostburg and other local government entities are now participating.

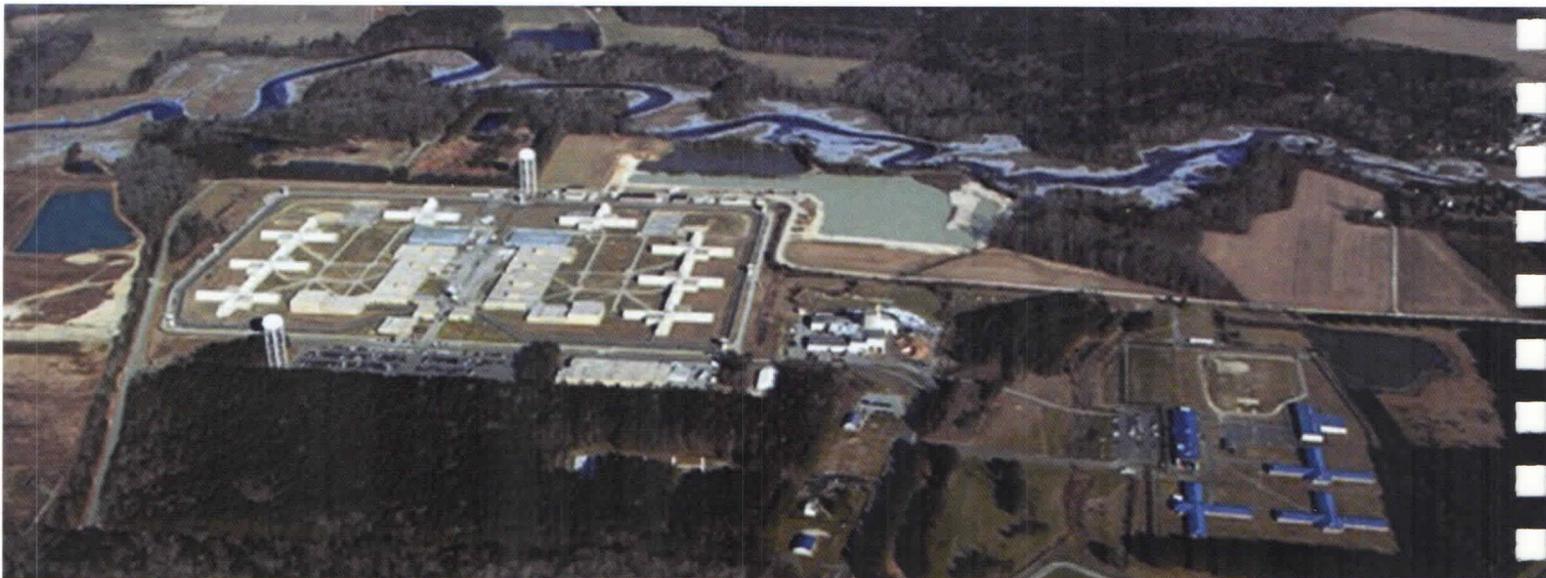
Award-winning team at Brown Station leachate pretreatment facility



In 2011, the Brown Station Road Sanitary Landfill/Leachate Pretreatment Facility won the Washington Suburban Sanitary Commission's third Annual Pretreatment Recognition Award. An independent panel of judges recognized Brown Station's attention to pollution prevention programs, training, safety and commitment to comply with local discharge limitations.

Only one significant industrial user wins the WSSC's award. The winning facility must demonstrate excellence by maintaining consistent compliance with Federal, State and local pretreatment standards and requirements and proven pollution prevention measures.

"It's a team effort to go a year with no permit violations," said Trish Lyons, Assistant Regional Supervisor. "The client is also supportive of our efforts and is always willing to give us their time, financial support and assistance."



Eastern Correctional Institution

AMERICAN RECOVERY AND REINVESTMENT ACT FUNDING EXPANDS ECI IMPROVEMENTS AND SOMERSET COUNTY WATER UPGRADES

The Eastern Correctional Institution (ECI) in Somerset County is a Department of Public Safety and Correctional Services (DPSCS) prison facility. The current prison population consists of approximately 3,400 inmates and a prison staff of 800. The Institution, which has been in operation since 1985, has its own dedicated water and wastewater treatment facilities and cogeneration power facility, operated/owned by MES.

The water from area wells contains high total dissolved solids, primarily fluoride, sodium, and chloride, which requires treatment. The high concentrations of minerals exceed the National Secondary Drinking Water Standards and can only be removed by use of a reverse osmosis (RO) membrane treatment system.

SCOPE OF ECI WTP PROJECT

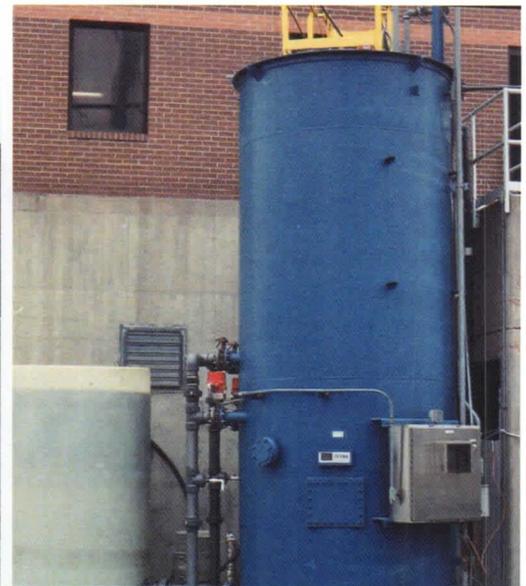
In 2009, MES and DPSCS were asked to assist the Somerset County Sanitary District (SCSD) in providing water to their customers in the Southern portion of the County. Although the Sanitary District had planned to drill

deep wells and install an elevated water tower, they had no funding available to construct their own RO treatment system.

However, MES had the design of its facility underway and applied for American Recovery and Reinvestment Act (ARRA) funding for the project on behalf of the County. A two million dollar grant was approved, and Watek Engineering Corporation revised the design to incorporate the SCSD's projected demand.

Specific project components included three new RO skids, a chemical feed system, cartridge filters to remove large particles prior to the RO, chlorine disinfection system, associated piping and pumps, instrumentation, and installation of controls in the existing ECI water treatment plant building. Also included in the project was the construction of approximately 3,200 linear feet of raw water pipeline from the two new SCSD wells, as well as finished water pipeline from the treatment plant to the SCSD distribution system.

Completed in 2011, the upgraded water treatment plant at ECI is now ready to supply safe drinking water to both the prison and to the Somerset County Sanitary District.



Reverse Osmosis Upgrades at ECI

ECI REVERSE OSMOSIS REJECT WATER TREATMENT PILOT PLANT PROJECT

Although the RO system at ECI provides outstanding treatment of the well water, it generates a large volume of reject water. The reject contains chemical constituents that were removed during the treatment process and requires additional treatment prior to disposal.

Although the RO reject will now be discharged with the wastewater treatment plant effluent, it must be first treated to meet the allowable levels defined in the discharge permit. Since RO reject is a non-typical type waste, MES felt it was necessary to test several treatment processes to confirm their ability to satisfactorily treat the reject water.

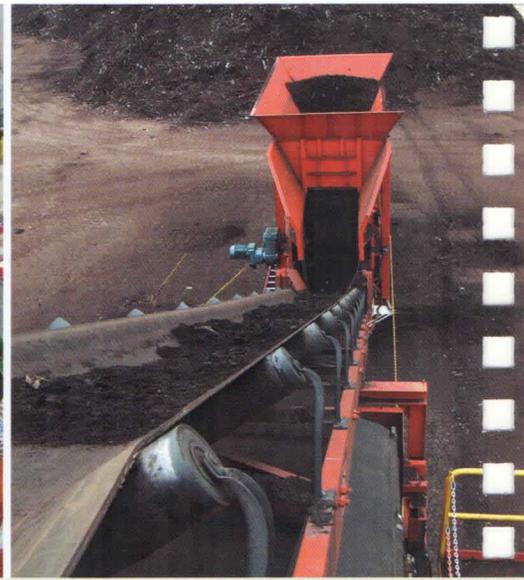
The objective of the pilot study was to evaluate the abilities of physical/chemical processes, membranes, and deep bed denitrification filters to treat a wastewater stream that contains both wastewater treatment plant (WWTP) effluent and reject water from the water treatment plant (WTP) to the required discharge limits. Specific treatment process equipment employed for pilot testing included:

- A Severn Trent Tetra Filtopack II Deep Bed Denitrification Filter, with methanol feed and nitrate analysis system;
- An Intuitech Flocculation and Sedimentation Module S200, with a Hach pH and turbidity meters;
- An Ultrafiltration (UF) Membrane System with feed tank.

With the above equipment, the following treatment regimes were evaluated during the pilot test:

- Following the breakpoint chlorination of the RO reject to purge ammonia, conventional flocculation/clarification and membrane treatment technologies were employed to treat the RO reject water to discharge limits.
- A deep bed denitrification filter was employed to treat a mixed stream of ECI WWTP effluent and the RO reject from step (a) to discharge limits.

The results of the pilot test showed that this equipment and the proposed operating regime were satisfactory in treating the RO reject along with the WWTP effluent.



Montgomery County Recycling Facility; Yard Waste Composting

ENVIRONMENTAL OPERATIONS

From a new regional landfill on the Eastern Shore to an award-winning state-of-the-art Recycling Center in Montgomery County, MES project managers and operators work to meet the solid waste disposal needs of Maryland communities.

RECYCLING

MES has operated the Baltimore County Resource Recovery Facility in Cockeysville since 1990. The facility serves the needs of Baltimore County residents in the areas of solid waste transfer, recovery and provides a convenient drop-off center for general solid waste and recycled materials.

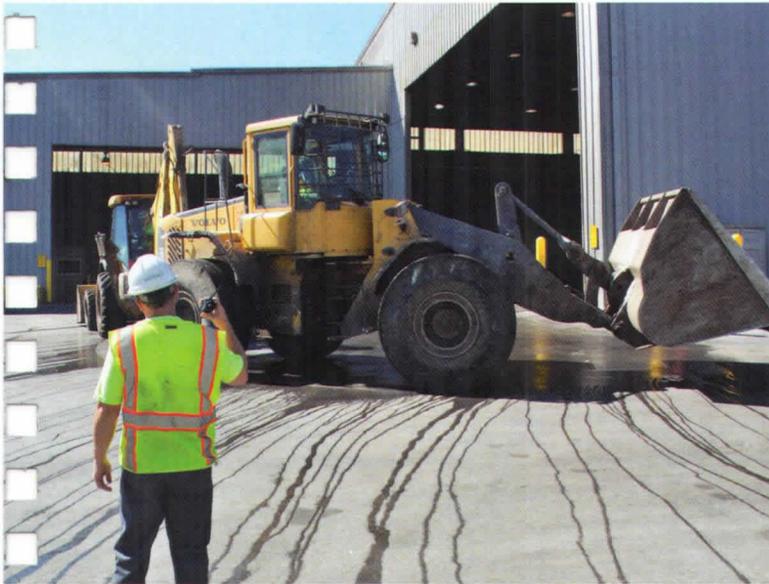
Forty-three MES employees staff the facility. In FY 2011, a total of 270,372 tons of trash was transferred through BCRRF via the TAF and CMRF areas. In addition, 236 tons of plastic, 60 tons of aluminum and 57 tons of steel were recovered from processing a stockpile of broken glass at BCRRF. These commodities were sold with the revenues reverting to Baltimore County to help offset operating costs.

In Montgomery County, MES operates an award-winning recycling facility that processed 28,048 tons of commingled recyclables in FY 2011. MES also provides recycling tours and educational programs for schoolchildren and citizens. The facility continues its expanded recycling efforts through the addition of injection-molded plastics, plastic flowerpots and buckets to its separation process.

For agencies and organizations seeking to improve recycling rates, MES provides program evaluation and training. MES recycling experts have worked with customers including the Maryland Aviation Administration at BWI Thurgood Marshall and Martin State Airports, Maryland Port Administration, Maryland Department of General Services, and the Maryland Stadium Authority.

YARD WASTE COMPOSTING

MES operates the Western Branch Composting Facility for Prince George's County. Yard waste, including grass, leaves, brush and Christmas trees, is collected from approximately 158,000 households in the County and delivered to the facility. After delivery, the yard waste



Western Acceptance Facility; Leafgro bagging operations at Dickerson

is placed in windrows and processed into compost. The compost is sold to wholesalers in bulk and is available to residents from retailers. In FY 2011, MES processed more than 57,600 tons of yard waste through this facility, resulting in the sale of 45,937 yards of Leafgro® leaf compost.

MES began operating Montgomery County Yard Trim Waste Facility in 1983. Approximately 77,000 tons of grass, leaves and small branches are processed at the facility annually. The material is composted and sold in bulk and bags as Leafgro®.

CRAB CHUM COMPOSTING

MES conducted a technology feasibility study in cooperation with the Department of Agriculture's Research facility in Beltsville. The study showed that crab chum can be used to generate high grade compost suitable for horticultural utilization.

Ann Rice, Manager, Recycled Products, and the MES Leafgro team broke all-time sales records for bagged Leafgro.

Ann's efforts put Leafgro back on the shelves at Home Depot and Lowes stores. During FY 2011, MES sold 493,614 bags of Leafgro, an 83% increase over FY 2009 sales. MES also sold 60,602 yards of Leafgro in bulk during FY 2011, which amounted to a 55% increase over FY 2009 sales.

By reestablishing a relationship with a large distributor, Ann was able to not only stop declining sales, but generate record sales during an economic downturn.





Garner scrap tire clean-up, before and after

SCRAP TIRE PROGRAM

Through the Maryland Department of the Environment, MES uses proceeds from the Maryland Scrap Tire Fund to clean-up illegal tire dumps and create demonstration projects using recycled rubber.

PUBLIC SCHOOL PLAYGROUND & ATHLETIC FIELD IMPROVEMENTS

MES and Maryland Department of the Environment have worked in cooperation with the state Department of Education to improve school facilities using recycled material. Over the past ten years, 85 playgrounds, 2 athletic tracks and 4 athletic fields have been improved and made safer, while recycling the equivalent of over 258,000 tires. The goal is not only to increase the quality of school athletic and play surfaces but also to demonstrate the innovative approaches available for the reuse of scrap tires.

SCRAP TIRE DUMP CLEANUPS

The Garner/Brandywine Scrap Tire Cleanup Project, thought to be the largest remaining illegal tire dump in Maryland, contained an estimated 1.25 million tires covering over 15 acres of ravines not far from a stream. The first phase of the cleanup began in FY 2010. Because of the size and expanse of this project, MES anticipates continued work into FY 2014. In FY 2011 a total of 2,900 tons of tires were removed from Ravine #5. The entire site is being restored to pre-dump natural conditions, including restoration of non-tidal wetlands and native trees.

The Garner/Brandywine site was selected for funding through a low interest loan program administered by Maryland Department of the Environment's Water Quality Revolving Fund. The estimated \$7 million loan will enable the award of all remaining work, reducing delays caused by phasing parts of the job over multiple years.



Midshore I Landfill flare

USED OIL PROGRAM

In FY 2011, MES contractors collected 685,471 gallons of used oil and 44,805 gallons of antifreeze. This program administered by MES on behalf of the Maryland Department of the Environment remains a popular recycling initiative for automotive and boating enthusiasts.

BENEFICIAL USE OF LANDFILL GAS

Methane is one of the most potent greenhouse gases: it is 20 to 25 times more powerful in trapping heat in the atmosphere than carbon dioxide. MES has entered into a long-term contract that will allow Blue Source, a leading firm in the areas of green house gas emissions reduction, to install and operate a central flare station on the Midshore I site.

Blue Source will calculate and verify the quantity of methane gas destroyed by the flare and then develop and sell the Verified Emission Reductions into the voluntary carbon market.

Future phases of the project will allow Blue Source and its partner, SCS Engineers, to expand the project into the areas of direct marketing of the methane gas and the generation and sale of electricity.

These endeavors are in keeping with Governor O'Malley's goals for the State of Maryland to improve the environment and to reduce energy dependency on fossil fuels. In addition, revenues generated from this project will be reinvested into the maintenance of the Midshore facility after it closes at the end of calendar year 2010, saving the counties and their citizens increased waste disposal fees and/or taxes.

EASTERN CORRECTIONAL INSTITUTION

MES operates and maintains a wood fired co-generation facility at the Eastern Correctional Institution in Westover, MD, generating steam, high temperature hot water, and electricity for use by the Institution which houses approximately 3,400 inmates. MES provides approximately 85% of the electrical and 100% of the thermal needs for this facility from the co-generation facility.



Hobbs Road Landfill closure project

MIDSHORE REGIONAL LANDFILL

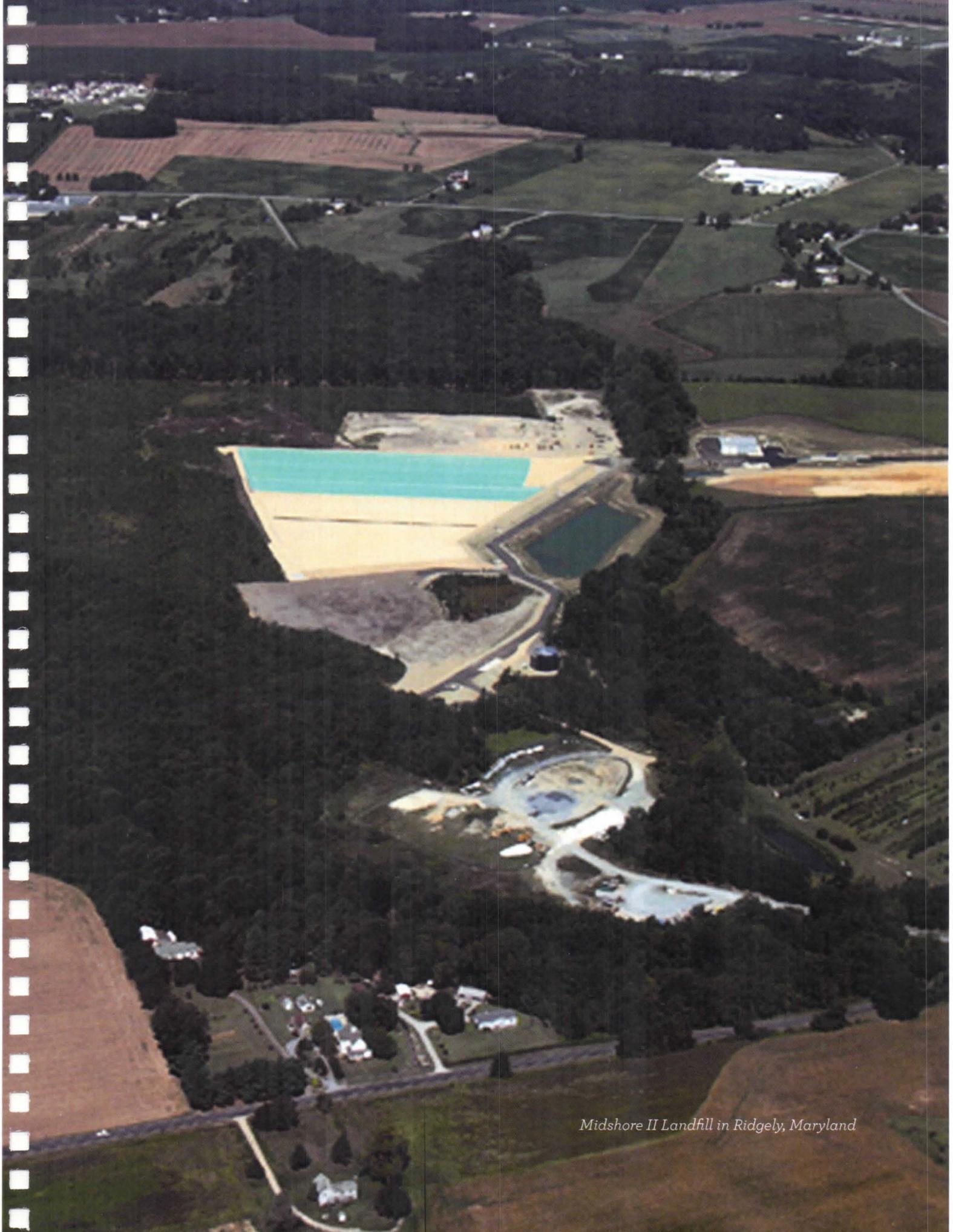
As part of an 80-year solution to solid waste management, the four Midshore Counties, Caroline, Kent, Queen Anne's and Talbot, have formed a unique partnership where each county hosts a solid waste facility for 20 years. Constructed in 1991, the Midshore I Regional Solid Waste Facility located in Talbot was the first waste acceptance facility to operate under the agreement. In addition to the disposal of solid waste, Midshore I also provided disposal of household hazardous waste, pesticides, motor oil, antifreeze, wood waste processing and refrigerant recovery. After 20 years of operation, Midshore I Landfill was closed on December 31, 2010 ending Talbot County's commitment to providing a disposal site for the Midshore Counties.

Construction of the next regional landfill in Ridgely (Midshore II) started in June 2009 and reached Substantial Completion in September 2010. On October 11, 2010, Midshore II Regional Solid Waste Facility opened for the acceptance of soft trash highlighted by an impromptu parade escorting the first load of waste into the landfill. In addition, MES began operating the new regional homeowner's drop-off located adjacent to Midshore II

at Holly Road in Ridgely. For the period of October 11, 2010 through the end of FY 2011 the new landfill accepted 63,892 tons.

Under a separate new agreement with Talbot County, MES began operation of a transfer station and homeowner drop-off at the Midshore I Landfill site in Easton. All solid waste delivered to Midshore I is transferred to the new Midshore II Facility for disposal, thus reducing truck traffic into Midshore II and saving fuel costs for Talbot County haulers. For the period January 1, 2011 through the end of the fiscal year, a total of 17,000 tons of solid waste was transferred to Midshore II from Midshore I.

In addition, work on the permanent closure of the existing Hobbs Road Landfill near Denton in Caroline County was initiated in July 2010. This closure activity is a requirement of MES to perform as part of the revised service agreement between MES and Caroline County associated with the Midshore II project. The state-of-the-art design included a geomembrane liner, geocomposite drainage layer, 18" drainage cap and 6" vegetative cover. Substantial completion of this project occurred in June 2011.



Midshore II Landfill in Ridgely, Maryland

FINANCIAL SECTION

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SB & COMPANY, LLC
EXPERIENCE • QUALITY • CLIENT SERVICE

Report of Independent Public Accountants

To the Board of Directors
Maryland Environmental Service

We have audited the accompanying financial statements of the business type activities and fiduciary fund of the Maryland Environmental Service (the Service), a component unit of the State of Maryland, as of and for the years ended June 30, 2011 and 2010, which collectively comprise the Service's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Service's management. Our responsibility is to express opinions on these financial statements based on our audits.

We conducted our audits 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 of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above presents fairly, in all material respects, the respective financial position of the Maryland Environmental Service as of June 30, 2011 and 2010, and the respective changes in financial position and cash flows, where applicable, thereof for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued our report dated September, 28 2011, on our consideration of the Services' 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audits.

Accounting principles generally accepted in the United States of America require that management's discussion and analysis and required supplemental information for other postemployment benefit plan be presented to supplement the basic financial statements. Such information, although not 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 inquires 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 evidence sufficient to express an opinion or provide any assurance.

Hunt Valley, Maryland
September 28, 2011

SB & Company, LLC

200 International Circle • Suite 5500 • Hunt Valley • Maryland 21030 • P 410-584-0060 • F 410-584-0061

**Maryland Environmental Service
Management Discussion and Analysis
June 30, 2011 and 2010
(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, 2011 and 2010. 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.

Grant Revenue

Certain restatements have been made to grant amounts previously reported below operating income to operating revenue. These restatements have been made to reflect a more proper matching of revenue and expenses. The change had no impact on the net assets of the Service.

The following table presents condensed financial information about the Service's net assets as of June 30, 2011, 2010 and 2009:

**Net Assets
(Expressed in Thousands)**

	2011	2010	2009
Current and other assets	\$ 62,368	\$ 61,637	\$ 75,667
Capital assets	14,617	15,835	16,695
Total assets	76,985	77,472	92,362
Current and long-term debt and capital leases	9,877	15,704	18,771
Other liabilities	50,598	45,837	61,421
Total liabilities	60,475	61,541	80,192
Net assets:			
Invested in capital assets, net of related debt	6,157	6,122	5,655
Restricted	11	10	9
Unrestricted	10,342	9,799	6,506
Total net assets	\$ 16,510	\$ 15,931	\$ 12,170

**Maryland Environmental Service
Management Discussion and Analysis
June 30, 2011 and 2010
(In thousands except where noted)**

Fiscal Year 2011

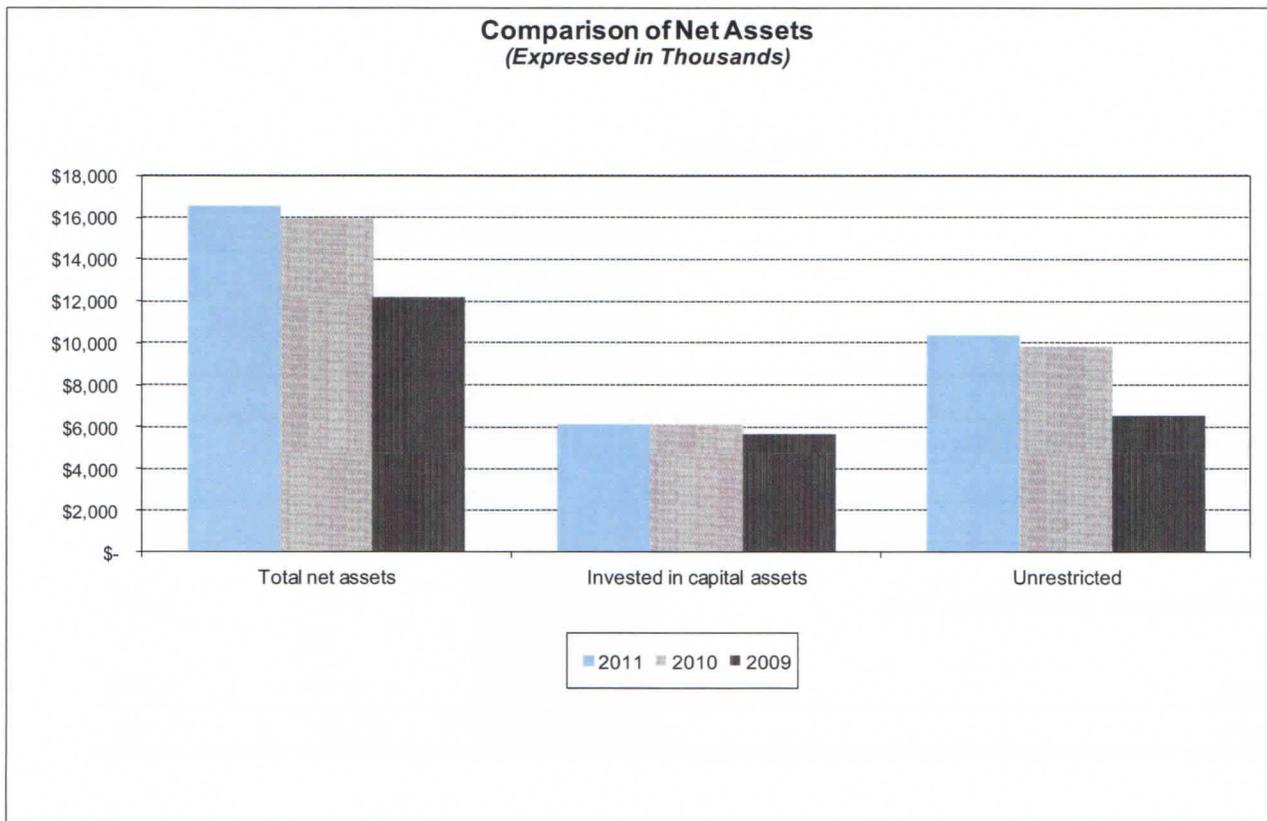
Total net assets increased \$579 thousand to \$16,510 thousand from 2010. The components of net assets are invested in capital assets net of related debt, restricted and unrestricted net assets.

Invested in capital assets net of related debt reflects the equity in capital assets. The increase of \$35 thousand is the result of net of disposals in capital assets of \$1,192 thousand offset by payment of related debt of \$1,227 thousand. Unrestricted net assets increased \$543 thousand. This portion of the Service's net assets is the residual balance of net assets excluding investment in capital assets net of related debt and restricted net assets.

Fiscal Year 2010

Net assets represent the difference between total assets and total liabilities. Combined net assets increased \$3,761 thousand in 2010 which related to the excess of revenue over expenses. Invested in capital assets, net of related debt increased \$467 thousand from the payment of debt net of depreciation. The remaining component of restricted and unrestricted net assets, \$9,809 thousand represents funds available for future expenditures. Over time, increases and decreases in net assets provide an indicator of improving or deteriorating financial position.

A comparison of years ended June 30, 2011, 2010 and 2009, are presented graphically below:



**Maryland Environmental Service
Management Discussion and Analysis
June 30, 2011 and 2010
(In thousands except where noted)**

The following table presents condensed financial information about the Service's revenue, expenses and changes in net assets for the years ended June 30, 2011, 2010 and 2009:

Changes in Net Assets <i>(Expressed in Thousands)</i>			
	2011	2010	2009
Total operating revenue	\$ 108,762	\$ 119,336	\$ 107,556
Operating expenses			
Salaries and benefits	38,466	38,671	37,185
Other	55,786	66,510	54,542
General and administrative	12,283	9,152	10,998
Total operating expenses	106,535	114,333	102,725
Operating income	2,227	5,003	4,831
Nonoperating expense, net	(1,648)	(1,242)	(876)
Change in net assets	579	3,761	3,955
Net assets, beginning of year	15,931	12,170	8,215
Net assets, end of year	\$ 16,510	\$ 15,931	\$ 12,170

The following table presents revenue by business type activity for the years ended June 30, 2011, 2010 and 2009:

Revenue by Business Type Activity <i>(Expressed in Thousands)</i>			
	2011	2010	2009
Environmental Dredging & Restoration	\$ 28,063	\$ 41,573	\$ 27,440
Water/Wastewater Operations	21,825	25,727	25,420
Recycling	15,225	14,533	16,622
Solid Waste Management	8,379	9,495	9,748
Energy Co-Generation	6,371	6,117	6,536
Environmental Engineering	2,170	287	162
Environmental Monitoring	16,758	13,757	13,906
Hazardous Waste Treatment	5,034	6,978	5,580
Grants	4,717	581	1,821
Other	220	288	321
Total Revenue	\$ 108,762	\$ 119,336	\$ 107,556

**Maryland Environmental Service
Management Discussion and Analysis
June 30, 2011 and 2010
(In thousands except where noted)**

Revenue by Business Type Activity

Fiscal Year 2011

Overall total revenue of \$108,762 thousand decreased \$10,574 thousand or 9% compared to prior year. The major segments contributing to the change were Environmental Dredging and Restoration decreased \$13,510 thousand, Water/Wastewater Operations decreased \$3,902 thousand, Solid Waste Management decreased \$1,116 thousand, Environmental Engineering increased \$1,883 thousand, Environmental Monitoring increased \$3,001 thousand, Hazardous Waste Treatment decreased \$1,944 thousand and Operating Grants increased \$4,136 thousand.

The decreased revenue in Environmental Dredging and Restoration was due to completion in 2010 of the Phase I dike construction for the Masonville Dredged Material Containment Facility, which involved significant pass through contractor payments. Water and Waste/Water lower revenues reflected the impact of the economic slowdown resulting in lower customer operating budgets and lower debt service payments related to bonds paid off in 2011. Solid Waste revenue declined because of the shutdown of a recycling facility in preparation for moving to single stream recycling and the cancellation of a waste transfer contract with Baltimore City. Environmental Monitoring revenue increased significantly from increased and new initiatives with State Highway and Motor Vehicle Administration. Hazardous Waste Treatment revenues were lower as a result of directives to implement measures to reduce contractor support and fewer construction site projects in 2011. Increased grant activity is related to funding received from EPA and DOT.

Fiscal Year 2010

Total operating revenue for the year ended 2010 increased \$13,020 thousand over 2009. This change represents an increase of 12%. The most significant areas of change were increases in Environmental Dredging and Restoration of \$14,133 thousand and Hazardous Waste Treatment of \$1,398 thousand, net of a decrease in Recycling of \$2,089 thousand.

Environmental Dredging and Restoration revenue was higher due to completing most of the dike construction at the Masonville dredged material containment facility, the project located off the Patapsco River near the Baltimore Harbor. Revenue increases from Hazardous Waste Treatment were attributed to environmental support activities related to project site preparation, remediation and leachate handling. Recycling revenue decreased 13% to \$14,533 thousand in 2010 compared to \$16,622 thousand in 2009. The decline in Recycling revenue is mostly due to a reduction in several large scrap tire cleanup projects completed during the year and reduced capital equipment spending at recycling facilities compared to the prior year.

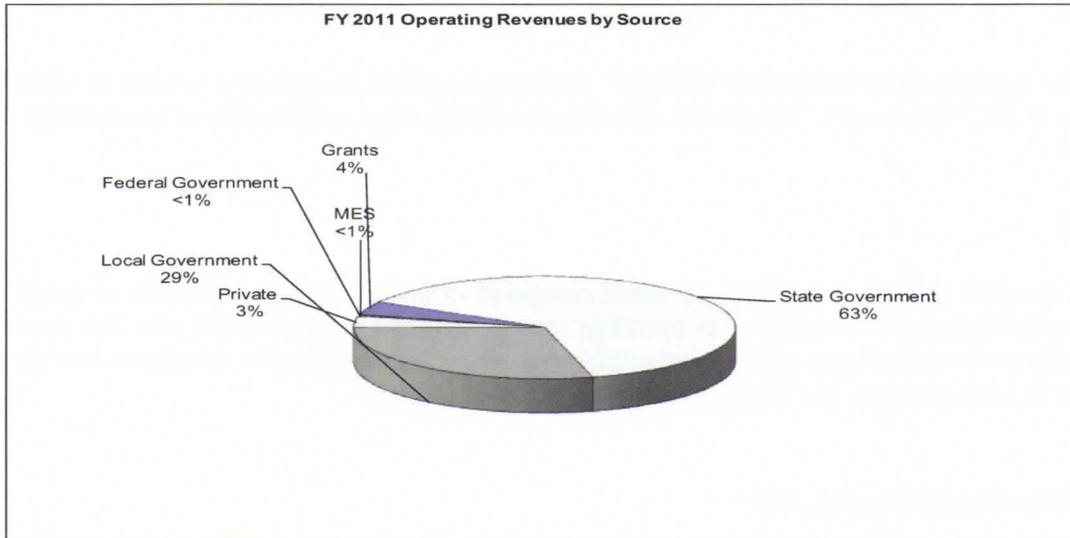
The following table presents revenue by source for the years ended June 30, 2011, 2010 and 2009:

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

	2011	2010	2009
State government	\$ 68,093	\$ 82,482	\$ 65,825
Local government	31,506	32,257	35,974
Private	3,800	3,409	3,294
Federal government	374	375	437
MES product revenues	272	232	205
Grants	4,717	581	1,821
Total Revenues	\$ 108,762	\$ 119,336	\$ 107,556

**Maryland Environmental Service
Management Discussion and Analysis
June 30, 2011 and 2010
(In thousands except where noted)**

The following graph presents revenue by source for the years ended June 30, 2011:



Revenue by Source

Fiscal Year 2011

The largest portion of the decrease in total revenue was State government representing \$14,389 thousand. The decrease referred to earlier under Revenue by Type Activity is related exclusively to reduced construction activity at the Masonville dredging project for the Maryland Port Administration.

Local government revenues declined \$751 thousand from 2010 to 2011. The decrease is due to the closure of a recycling facility and transfer of materials until a single stream processing line is completed.

Fiscal Year 2010

State and local government revenue account for 99% of the \$13,020 thousand increase in total revenue over last year. State government revenue increase of \$16,657 thousand was offset by a decrease in local government revenue of \$3,717 thousand.

Revenue related to the dike construction work at the Masonville dredged material containment facility is the primary reason for the State government revenue increase. The decrease in local government is the result of scaling back levels of effort and contractor budget reductions on Geographic Information Systems (GIS) projects.

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 98%, 96%, and 97% of revenue in 2011, 2010 and 2009, respectively.

**Maryland Environmental Service
Management Discussion and Analysis
June 30, 2011 and 2010
(In thousands except where noted)**

Operating Income

Fiscal Year 2011

In 2011, the Service reported operating income of \$2,227 thousand compared to operating income of \$5,003 thousand in 2010, a decrease of \$2,776 thousand. The factors affecting the change are a combination of lower fringe benefit and overhead recovery.

Fiscal Year 2010

Operating income reported in 2010 was \$5,003 thousand compared to \$4,831 thousand in 2009, an increase of \$172 thousand. The principal reason for the increase in operating income from the previous fiscal year was that the Service incurred significantly lower general and administrative expenses along with an increase in indirect cost recovery as a result of the growth in labor revenue, and it was offset by the decrease in grant.

Non-operating Revenue (Expense), Net

Fiscal Year 2011

Non-operating expenses, net increased \$406 thousand over 2010. The most significant portion of the change is attributable to the \$1,075 thousand contribution to the State's General Fund. This represents an increase of \$575 thousand over 2010. The other components include a decrease in investment income of \$46 thousand, a decrease in interest expense \$293 and a decrease in the net gain on the sale of equipment of \$78 thousand. Lower market interest rates on short-term investments contributed to significantly less interest income earned. During fiscal year 2011 the payoff of long-term debt and leased equipment contributed to lower interest expense.

Fiscal Year 2010

Non-operating expense, net increased \$366 thousand to \$1,242 thousand in 2010. The change in non-operating expense (net) during 2010 consisted of a decrease in interest income of \$93 thousand, a decrease in interest expense of \$130 thousand, a \$500 thousand contribution to the State's General Fund and a gain on the sale of assets of \$114 thousand.

Grants

Fiscal Year 2011

Grant activity in 2011 of \$4,717 thousand included Federal grants of \$2,369 thousand, State grants of \$2,299 and Private grants of \$49 thousand.

Fiscal Year 2010

Grant funds received of \$581 thousand in 2010 were all related to operating grants. The source of these grants is the Environmental Protection Agency (EPA) for projects on behalf of the Maryland Port Administration (MPA). Projects are related to assessment and implementation of clean diesel technologies.

**Maryland Environmental Service
Management Discussion and Analysis
June 30, 2011 and 2010
(In thousands except where noted)**

Investment in Capital Assets

The following tables present capital assets net of depreciation as of June 30, 2011, 2010 and 2009, and capital expenditures for the years ended June 30, 2011, 2010 and 2009:

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

	2011	2010	2009
Land and improvements	\$ 1,223	\$ 1,223	\$ 1,070
Buildings and improvements	8,765	8,980	9,396
Infrastructure	431	502	200
Machinery and equipment	4,198	4,919	5,392
Construction in progress, net change	-	211	637
Total	\$ 14,617	\$ 15,835	\$ 16,695

**Capital Expenditures
(Expressed in Thousands)**

	2011	2010	2009
Land and improvements	\$ -	\$ 153	\$ -
Autos and trucks	332	659	452
Construction and production equipment	19	(4)	83
Computer hardware/software	251	223	319
Tools/machinery/equipment	5	9	41
Buildings	211	-	6,503
Leasehold improvements	-	393	-
Construction in progress, net change	(211)	(426)	483
Total	\$ 607	\$ 1,007	\$ 7,881

Fiscal Year 2011

At the end of 2011, the carrying value of capital assets, net of depreciation was \$14,617 thousand, a decrease of \$1,218 thousand from 2010. The decrease is comprised of capital additions \$818 thousand, net disposals of \$391 thousand, depreciation of \$1,646 thousand and transfers in of \$1 thousand. Capital expenditures decreased \$400 thousand in 2011 as a result of lower capital spending and asset retirements.

Fiscal Year 2010

As of June 30, 2010, the Service had invested \$15,835 thousand in capital assets, net of depreciation in various categories. Overall, capital assets decreased \$860 thousand in 2010. The change from prior year is comprised of capital additions of \$1,433 thousand, depreciation of \$1,769 thousand, asset retirements of \$1,129 thousand and change in construction in progress of \$426 thousand. The bulk of capital additions in 2010 was for vehicle replacement of \$659 thousand and leasehold improvements of \$393 thousand.

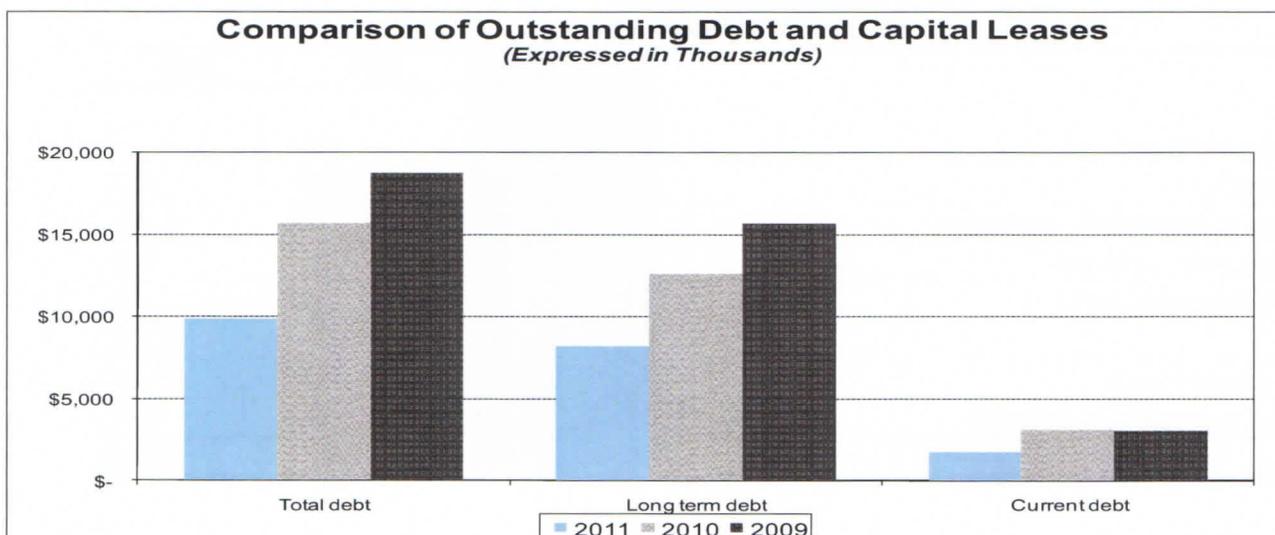
**Maryland Environmental Service
Management Discussion and Analysis
June 30, 2011 and 2010
(In thousands except where noted)**

Outstanding Debt

The following table and graph present outstanding debt as of June 30, 2011, 2010 and 2009:

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

	2011	2010	2009
Revenue bonds	\$ 1,359	\$ 4,942	\$ 5,751
Certificates of participation	-	665	1,284
Capital leases	8,055	9,600	11,206
General Obligation Bond-Note	463	497	530
Total	\$ 9,877	\$ 15,704	\$ 18,771



Fiscal Year 2011

As of June 30, 2011, outstanding debt was \$9,877 thousand, representing a net decrease in borrowing of \$5,827 from 2010. The net decrease consists of principal payments in the amount of \$5,839 thousand and amortization of bond discount \$12 thousand.

Fiscal Year 2010

As of June 30, 2010, outstanding debt of \$15,704 thousand consisted of bond debt of \$6,104 thousand and capital leases of \$9,600 thousand. The net decrease of \$3,067 thousand from 2009 was made up of principal payments \$3,074 thousand and amortization of bond discount of \$7 thousand.

**MARYLAND ENVIRONMENTAL SERVICE
FINANCIAL STATEMENTS**

Maryland Environmental Service
Statements of Net Assets
As of June 30, 2011 and 2010
(Expressed in Thousands)

Assets	2011	2010
Current assets:		
Cash and cash equivalents	\$ 35,805	\$ 24,850
Restricted cash	426	551
Investments	2,001	6,830
Accounts receivable (net of allowance of \$50)	15,994	13,395
Unbilled project costs accrued	4,044	2,405
Net investment direct financing leases	691	2,077
Other	91	62
Total current assets	59,052	50,170
Other assets:		
Restricted cash	827	1,870
Restricted investments	-	5,177
Due from project participants	2,404	2,363
Net investment direct financing leases	85	2,057
Capital assets, net of accumulated depreciation:		
Land	1,223	1,223
Buildings and improvements	8,765	8,980
Infrastructure	431	502
Machinery and equipment	4,198	4,919
Construction in progress	-	211
Total capital assets	14,617	15,835
Total other assets	17,933	27,302
Total assets	76,985	77,472
Liabilities		
Current liabilities:		
Accounts payable and accrued expenses	13,665	9,695
Accrued annual leave	2,509	2,346
Due to Midshore and other projects	9,596	5,182
Advances from project participants	20,543	23,999
Current portion of long-term debt and capitalized leases	1,702	3,109
Accrued workers' compensation costs	373	366
Total current liabilities	48,388	44,697
Other liabilities:		
Advances from project participants	1,881	2,252
Long-term debt and capitalized leases, net of current portion and bond discount	8,175	12,595
Accrued workers' compensation costs	2,031	1,997
Total other liabilities	12,087	16,844
Total liabilities	60,475	61,541
Net Assets		
Invested in capital assets, net of related debt	6,157	6,122
Restricted net assets	11	10
Unrestricted net assets	10,342	9,799
Total net assets	\$ 16,510	\$ 15,931

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

Maryland Environmental Service
Statements of Revenue, Expenses and Changes in Net Assets
For the years ended June 30, 2011 and 2010
(Expressed in Thousands)

	<u>2011</u>	<u>2010</u>
Operating revenue:		
Charges for services	\$ 104,045	\$ 118,755
Operating grants	4,717	581
Total operating revenue	108,762	119,336
Operating expenses:		
Salaries and benefits	38,466	38,671
Contractual services	19,715	17,775
Technical fees	6,764	9,372
Utilities	4,439	5,096
Repairs and maintenance	6,076	3,545
Materials and supplies	6,262	5,633
Land, structures and equipment	10,387	22,855
Depreciation	1,646	1,193
General and administrative	12,283	9,152
Other	497	1,041
Total operating expenses	106,535	114,333
Operating income	2,227	5,003
Nonoperating revenue (expenses):		
Investment income	31	77
Interest expense	(640)	(933)
Other transfer to State general fund expenses	(1,075)	(500)
Gain sale of equipment, net	36	114
Nonoperating expenses, net	(1,648)	(1,242)
Change in net assets	579	3,761
Net assets, beginning of year	15,931	12,170
Net assets, end of year	\$ 16,510	\$ 15,931

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

Maryland Environmental Service
Statements of Cash Flows
For the years ended June 30, 2011 and 2010
(Expressed in Thousands)

	2011	2010
Cash Flows From Operating Activities		
Receipts from customers	\$ 104,525	\$ 135,639
Payments to suppliers	(62,262)	(79,304)
Payments to employees	(38,494)	(38,654)
Payments to/from project participants	(3,867)	(10,590)
Other receipts project Midshore	4,414	315
Other	11	(135)
Net cash from operating activities	4,327	7,271
Cash Flows From Noncapital Financing Activities		
Transfers to other funds	(1,075)	(500)
Net cash from noncapital financing activities	(1,075)	(500)
Cash Flows From Capital and Related Financing Activities		
Purchases of capital assets	(453)	(914)
Principal paid on capital debt	(5,839)	(3,073)
Interest paid on capital debt	(628)	(926)
Increase in lease	3,358	1,759
Other receipts	68	119
Net cash from capital and related financing activities	(3,494)	(3,035)
Cash Flows From Investing Activities		
Purchases of investments	(14,465)	(73,379)
Sales and maturities of investments	25,627	94,065
Interest and dividends	35	69
Net cash from investing activities	11,197	20,755
Net increase in cash and cash equivalents	10,955	24,490
Cash and cash equivalents - beginning of the year	24,850	360
Cash and cash equivalents - end of the year	\$ 35,805	\$ 24,850
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 2,227	\$ 5,003
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization expense	1,646	1,770
Change in assets and liabilities:		
Receivables, net	(2,599)	12,779
Other assets and inventory	(1,707)	2,913
Accounts and other payables	4,133	(5,394)
Due to project participants	(3,827)	(10,352)
Net change due to/from Midshore	4,414	315
Accrued workers compensation	40	237
Net cash from operating activities	\$ 4,327	\$ 7,271

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

Midshore Regional Landfill Private Purpose Trust Fund

Statements of Net Assets

As of June 30, 2011 and 2010

(Expressed in Thousands)

Assets	2011	2010
Current assets:		
Cash and cash equivalents	\$ 46	\$ -
Due from MES	9,625	5,177
Accounts receivable	2,600	544
Total current assets	12,271	5,721
Other assets:		
Restricted investments	4,694	7,263
Bond issuance cost	111	-
Capital assets not depreciated	1,690	15,320
Capital assets being depreciated, net	20,217	4,397
Total capital assets	21,907	19,717
Total other assets	26,712	26,980
Total assets	38,983	32,701
Liabilities		
Current liabilities:		
Accounts payable and accrued expenses	606	1,312
Advances from project participants	483	483
Due to Midshore Recycling	150	128
Current portion of long-term debt and capitalized leases	940	12,270
Total current liabilities	2,179	14,193
Other liabilities:		
Long-term debt and capitalized leases, net of current portion and bond discount	20,335	484
Accrued landfill closure & postclosure care costs	9,187	11,236
Total other liabilities	29,522	11,720
Total liabilities	31,701	25,913
Net Assets		
Invested in capital assets, net of related debt	3,408	6,963
Net assets designated-closure/post closure	4,954	5,772
Net assets designated-Easton	870	870
Unrestricted net assets	(1,950)	(6,817)
Total net assets	\$ 7,282	\$ 6,788

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 Assets
For the years ended June 30, 2011 and 2010
(Expressed in Thousands)

	2011	2010
Operating revenue:		
Charges for services	\$ 7,067	\$ 5,279
Operating expenses:		
Salaries and benefits	1,266	1,172
Contractual services	1,473	377
Technical fees	41	42
Utilities	35	33
Operations and maintenance	311	280
Materials and supplies	286	653
Land, structures and equipment	1,444	13
Depreciation	3,799	1,148
Closure/post closure	608	646
General and administrative	391	359
Other	33	25
Total operating expenses	9,687	4,748
Operating (loss) income	(2,620)	531
Nonoperating revenue (expenses):		
Amortization bond issuance cost	(3)	-
Interest income	25	18
Other revenue	5	1
Interest expense	(348)	(47)
Change in estimated closure post closure costs	2,087	-
Nonoperating revenues, net	1,766	(28)
Capital grants	1,348	-
Change in net assets	494	503
Net assets, beginning of year	6,788	6,285
Net assets, end of year	\$ 7,282	\$ 6,788

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

MARYLAND ENVIRONMENTAL SERVICE	
Other Post Employment Benefit Plan	
Statement of Plan Net Assets	
As of June 30, 2011	
Assets	
Cash and short-term investments	\$ 64,776
Investments	
Equities	751,620
Fixed income	205,220
Real estate	55,748
Other	33,486
Total investments	1,046,074
Total assets	1,110,850
Liabilities	
Accounts payable	-
Total liabilities	-
Net assets held in trust for other postemployment benefits	\$ 1,110,850

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

MARYLAND ENVIRONMENTAL SERVICE	
Other Post Employment Benefit Plan	
Statement of Changes in Plan Net Assets	
As of June 30, 2011	
Additions	
Employer contributions	\$ 316,147
Investment Income	
Net appreciation in fair value of investments	151,266
Interests and dividends	19,486
	170,752
Less investment expense	3,810
Net investment gain	166,942
Total additions	483,089
Deductions	
Benefits paid	29,237
Net increase	453,852
Net assets held in trust for other postemployment benefits	
Net assets, beginning of year	656,998
Net assets, end of year	\$ 1,110,850

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

Maryland Environmental Service
Notes to Financial Statements
June 30, 2011 and 2010
(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, 2011 and 2010
(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. Also, in preparing its financial statements, the Service has adopted paragraph 6 of GASB Statement No. 20 titled *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting* under which the Service has applied only the applicable Financial Accounting Standards Board pronouncements issued on or before November 30, 1989, unless they conflict with GASB pronouncements.

In December 2010, the Governmental Accounting Standards Board (GASB) issued Statement No. 62 (GASB 62) *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* which intended to enhance the usefulness of the Codification of Governmental Accounting and Financial Reporting Standards by incorporating guidance that previously could only be found in certain FASB and AICPA pronouncements. The requirements of the GASB 62 are effective for financial statements for periods beginning after December 15, 2011. Earlier application is encouraged. The Service has evaluated the impact of the GASB 62 and did not expect a material impact on the financial statements.

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 revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with ongoing operations. The principal operating revenues of the Service are charges to customers for services. Operating expenses include the cost of services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses. Interest income is recognized as nonoperating revenue as earned of which \$4 thousand and \$7 thousand during the years ended June 30, 2011 and 2010 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 are based on quoted market prices.

Maryland Environmental Service
Notes to Financial Statements
June 30, 2011 and 2010
(In thousands except where noted)

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

(f) Direct Financing Leases

The Service acts as lessor in direct financing lease arrangements for certain customer's projects and equipment. Such leases expire over the next 3 years in conjunction with the retirement of the related debt.

(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. There was \$150 thousand interest capitalized in fiscal year 2011 and \$168 thousand interest capitalized in fiscal year 2010.

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 revenues, expenses and changes in net assets, 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 revenues, expenses and changes in net assets 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, 2011 and 2010
(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 postemployment benefits for current and future retirees. Contribution requirements are determined according to actuarial valuations. The Service contributed \$316 thousand in 2011 and \$713 thousand in 2010. Total reimbursement of medical expenses was \$29 thousand in 2011 and \$25 thousand in 2010.

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 year ending 2011 and 2010, the Service's annual OPEB cost was \$313 thousand and \$323 thousand and the net OPEB assets \$13 thousand as of June 30, 2011.

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

OPEB Cost (In Thousands)	2011	2010
Normal cost	\$ 136	\$ 136
Minimum amortization of UAL	155	156
Interest adjustment to year- end	22	22
Annual required contribution	313	314
ARC Adjustment	-	(20)
Interest adjustment to net OPEB obligation	-	29
 OPEB cost	 313	 323
 Contributions made	 (316)	 (713)
Interest adjustment to contributions made	(10)	-
Increase in net OPEB obligation	(13)	(390)
 Net OPEB obligation - beginning of year	 -	 390
 NET OPEB obligation (assets) - end of year	 \$ (13)	 -

Maryland Environmental Service
Notes to Financial Statements
June 30, 2011 and 2010
(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 January 1, 2009 was as follows:

Actuarial valuation date	1/01/2009
Actuarial value of assets	\$ -
Actuarial accrued liability	\$ 3,015
Unfunded actuarial liability	\$ 3,015
Funded ratio	0.0%
Annualized covered payroll	\$34,152
Ratio of unfunded actuarial liability to annual covered payroll	8.8%
Net OPEB obligation as of the valuation date	\$ -
Actuarial cost method	Entry age

As of the valuation date, the plan was 0% percent funded. The actuarial accrued liability for benefits was \$3,015 thousand resulting in an unfunded actuarial accrued liability of \$3,015 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 January 1, 2009, 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 2011 and \$82 thousand in 2010.

Maryland Environmental Service
Notes to Financial Statements
June 30, 2011 and 2010
(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, 2011 and 2010, there were no arbitrage rebate liabilities.

(m) *Cash Equivalents*

The Service considers its unrestricted cash, including overnight investments, to be cash and cash equivalents.

(n) *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.

(o) *Recent Pronouncements*

In December 2010, the Governmental Accounting Standards Board (GASB) issued Statement No. 61 (GASB 61) *The Financial Reporting Entity – Omnibus – An Amendment of GASB Statements No. 14 and No. 24* which intended to improve the information presented about the financial reporting entity, which is comprised of a primary government and related entities (component units). In addition, GASB 61 amends the criteria for blending - reporting component units as if they were part of the primary government - in certain circumstances. The requirements of the GASB 61 are effective for financial statements for periods beginning after June 15, 2012. Earlier application is encouraged. The Service has evaluated the impact of the GASB 61 and did not expect a material impact on the financial statements.

GASB No. 49 *Accounting and Financial Reporting for Pollution Remediation Obligations*, requires the Service to assess the impact of environmental matters on the Financial Statements. Management has considered the impact of this pronouncement on its financial statements and is not aware of any issues that would result in a remediation liability.

Maryland Environmental Service
Notes to Financial Statements
June 30, 2011 and 2010
(In thousands except where noted)

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

(p) Reclassification

Certain items in the 2010 financial statements have been reclassified to conform to the presentation in the 2011 financial statements. The reclassifications had no effect on net income.

(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 \$35,805 thousand and \$24,850 thousand on June 30, 2011 and 2010, respectively. Included, as cash equivalents for financial statement presentation, were certain overnight investments of \$29,454 thousand and \$18,571 thousand, respectively, as of June 30, 2011 and 2010, 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 investment with financial institutions must be fully collateralized.

As of June 30, 2011, the Service had the following investments and quality ratings:

<u>Investment Type</u>	<u>Fair Value</u> (In Thousands)	<u>Ratings by</u> <u>Organization</u> <u>Moody's</u>
Bank of America FNMA	\$ 2,001	Aaa

As of June 30, 2011, the Midshore Regional Landfill had the following investments and quality ratings:

<u>Investment Type</u>	<u>Fair Value</u> (In Thousands)	<u>Ratings by</u> <u>Organization</u> <u>Moody's</u>
Money Market Funds	\$ 1,585	Aaa

Maryland Environmental Service
Notes to Financial Statements
June 30, 2011 and 2010
(In thousands except where noted)

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

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.

The restricted cash and investments are comprised of the following funds as of June 30, 2011 and 2010:

Maryland Environmental Service:

	(In Thousands)	
	2011	2010
Trustee held:		
Construction Funds	\$ 7	\$ 74
Interest Funds	25	54
Rebate Funds	40	52
Principal Funds	354	371
	426	551
Debt Service Reserve Funds	498	1,870
Service held:		
Project restricted	329	5,177
	\$ 1,253	\$ 7,598

Midshore Regional Landfill:

	(In Thousands)	
	2011	2010
Trustee held:		
Interest		\$ 4
Closure Fund	759	759
Construction Funds	3,109	5,630
Service held:		
Liability Fund	822	870
	\$ 4,694	\$ 7,263

Maryland Environmental Service
Notes to Financial Statements
June 30, 2011 and 2010
(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 \$1,046,074 are uncollateralized and exposed to credit risk as of June 30, 2011.

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, 2011, the Plan had the following investments, which represented 5% or more of total investments:

Issue	Fair Value	Percentage
Vanguard Total Stock Market ETF	\$ 221,548	21%
DWS Sector TR	54,562	5
Dodge & Cox International Stock Fund	219,207	21
iShares MSCI EAFE Index Fund	218,469	21
Vanguard Total Bond Index Fund	162,292	16
T Rowe Price Real Estate Fund	55,748	5

Maryland Environmental Service
Notes to Financial Statements
June 30, 2011 and 2010
(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, 2011 and 2010 are presented below.

	2011	2010
Minimum lease payments receivable	\$ 1,775	\$ 7,331
Less – unearned income	114	815
	1,661	6,516
Less – restricted investments related to unexpended bond proceeds	885	2,382
Net investment in direct financing leases	\$ 776	\$ 4,134
Current	\$ 691	\$ 2,077
Non- current	85	2,057
Net investment in direct financing leases	\$ 776	\$ 4,134

As of June 30, 2011, lease payments receivable in the fiscal years were as follows:

Year ending June 30,		
2012	\$	763
2013		501
2014		511
Total	\$	1,775

Maryland Environmental Service
Notes to Financial Statements
June 30, 2011 and 2010
(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, 2011 and 2010:

Maryland Environmental Service:

2011	Balance 06/30/10	Additions	Deletions	Transfers In/Out	Balance 06/30/11
Capital assets, not depreciated					
Land and improvements	\$ 1,223	\$ -	\$ -	\$ -	\$ 1,223
Construction in progress	211	-	(211)	-	-
Total capital assets, not depreciated	<u>1,434</u>	<u>-</u>	<u>(211)</u>	<u>-</u>	<u>1,223</u>
Capital assets, being depreciated					
Structures and improvements	30,619	211	-	-	30,830
Equipment	13,851	607	(1,771)	1	12,688
Total capital assets being depreciated	<u>44,470</u>	<u>818</u>	<u>(1,771)</u>	<u>1</u>	<u>43,518</u>
Less accumulated depreciation for					
Structures and improvements	21,137	497	-	-	21,634
Equipment	8,932	1,149	(1,591)	-	8,490
Total accumulated depreciation	<u>30,069</u>	<u>1,646</u>	<u>(1,591)</u>	<u>-</u>	<u>30,124</u>
Total capital assets, net	<u>\$ 15,835</u>	<u>\$ (828)</u>	<u>\$ (391)</u>	<u>\$ 1</u>	<u>\$ 14,617</u>
2010					
Capital assets, not depreciated					
Land and improvements	\$ 1,070	\$ 153	\$ -	\$ -	\$ 1,223
Construction in progress	637	57	(483)	-	211
Total capital assets, not depreciated	<u>1,707</u>	<u>210</u>	<u>(483)</u>	<u>-</u>	<u>1,434</u>
Capital assets, being depreciated					
Structures and improvements	30,291	393	-	-	30,619
Equipment	14,028	887	(1,147)	-	13,851
Total capital assets being depreciated	<u>44,319</u>	<u>1,280</u>	<u>(1,147)</u>	<u>-</u>	<u>44,470</u>
Less accumulated depreciation for					
Structures and improvements	20,640	497	-	-	21,137
Equipment	8,691	1,272	(1,049)	-	8,932
Total accumulated depreciation	<u>29,331</u>	<u>1,769</u>	<u>(1,049)</u>	<u>-</u>	<u>30,069</u>
Total capital assets, net	<u>\$ 16,695</u>	<u>\$ (279)</u>	<u>\$ (581)</u>	<u>\$ -</u>	<u>\$ 15,835</u>

Maryland Environmental Service
Notes to Financial Statements
June 30, 2011 and 2010
(In thousands except where noted)

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

Midshore Regional Landfill:

2011	Balance 06/30/10	Additions	Deletions	Transfers In/Out	Balance 06/30/11
Capital assets, not depreciated					
Land and improvements	\$ 1,690	\$ -	\$ -	\$ -	\$ 1,690
Construction in progress	13,630	3,795	-	(17,425)	-
Total capital assets, not depreciated	<u>15,320</u>	<u>3,795</u>	<u>-</u>	<u>(17,425)</u>	<u>1,690</u>
Capital assets, being depreciated					
Structures and improvements	13,721	19,467	(3)	-	33,185
Equipment	5,136	154	(453)	(3)	4,834
Total capital assets being depreciated	<u>18,857</u>	<u>19,621</u>	<u>(456)</u>	<u>(3)</u>	<u>38,019</u>
Less accumulated depreciation for					
Structures and improvements	11,168	3,265	(3)	-	14,430
Equipment	3,292	569	(489)	-	3,372
Total accumulated depreciation	<u>14,460</u>	<u>3,834</u>	<u>(492)</u>	<u>-</u>	<u>17,802</u>
Total capital assets, net	<u>\$ 19,717</u>	<u>\$ 19,582</u>	<u>\$ 36</u>	<u>\$ (17,428)</u>	<u>\$ 21,907</u>
2010	Balance 06/30/09	Additions	Deletions	Transfers In/Out	Balance 06/30/10
Capital assets, not depreciated					
Land and improvements	\$ 1,690	\$ -	\$ -	\$ -	\$ 1,690
Construction in progress	5,003	8,627	-	-	13,630
Total capital assets, not depreciated	<u>6,693</u>	<u>8,627</u>	<u>-</u>	<u>-</u>	<u>15,320</u>
Capital assets, being depreciated					
Structures and improvements	\$ 13,721	\$ -	\$ -	\$ -	\$ 13,721
Equipment	4,744	369	23	-	5,136
Total capital assets being depreciated	<u>18,465</u>	<u>369</u>	<u>23</u>	<u>-</u>	<u>18,857</u>
Less accumulated depreciation for					
Structures and improvements	10,520	648	-	-	11,168
Equipment	2,815	454	23	-	3,292
Total accumulated depreciation	<u>13,335</u>	<u>1,102</u>	<u>23</u>	<u>-</u>	<u>14,460</u>
Total capital assets, net	<u>\$ 11,823</u>	<u>\$ 7,894</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 19,717</u>

Maryland Environmental Service
Notes to Financial Statements
June 30, 2011 and 2010
(In thousands except where noted)

(5) Construction Commitments

Midshore II Regional Landfill:

The project commenced operation in January 2011. The total cost for design and construction was \$18.2 million. The landfill was funded with project revenue bonds.

Hobbs Road Landfill:

Closure and capping was completed in May of 2011 for a cost of \$3.8 million. The project was funded with a Maryland Water Quality Financing Administration Loan.

(6) Concentrations of Credit

The Service derived approximately 63% and 69% of its revenue and had approximately 56% and 60% of accounts receivable outstanding in 2011 and 2010, 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 \$32 thousand for the years ended June 30, 2011 and 2010.

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, 2011 and 2010
(In thousands except where noted)

(7) Leases (In Thousands) (continued)

The future minimum lease obligations and the net present value of these minimum lease payments as of June 30, 2011, were as follows:

Years ending June 30:

2012	\$	1,646
2013		1,129
2014		842
2015		842
2016		842
2017-2021		3,839
2022-2025		1,495
Total minimum lease payments		10,635
Less: amount representing interest		(2,580)
Present value of minimum lease payments		8,055
Less current portion		(1,242)
Long term portion of capital leases	\$	6,813

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

Midshore Regional Landfill:

Years ending June 30:

2012	\$	272
2013		245
Total minimum lease payments		517
Less: amount representing interest		(33)
Present value of minimum lease payments		484
Less: current portion		(250)
Long term portion of capital leases	\$	234

Maryland Environmental Service
Notes to Financial Statements
June 30, 2011 and 2010
(In thousands except where noted)

(8) Debt (In Thousands)

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

Maryland Environmental Service:

	2011	2010
Water and Wastewater Certificate of Participation 1991 A		
Series; June 1991; \$0 and \$665 (less unamortized bond discount of \$0 and \$0 at June 30, 2011 and 2010 respectively); interest at 5.7% and 3.7% paid semiannually on June 1 and December 1; due in annual installments beginning in 1993 through 2011 in varying amounts from \$545 to \$665. Balance paid off in June 2011.	\$ -	\$ 665
Cecil County Landfill Project- Lease Revenue Bond, 2000 Series,		
July 2000; \$0 and \$3,190 (less unamortized bond discount of \$0 and \$10 at June 30, 2011 and 2010 respectively); interest at 4.74% to 5.5% paid semiannually on March 1 and September 1; principal due in annual installments beginning September 2001 through 2015 in varying amounts from \$285 to \$605. Cecil paid off remaining balance on November 2010.	-	3,180
Garett County Landfill Project Revenue Bonds, 1993 Series		
\$1,360 and \$1,765 (less unamortized bond discount of \$1 and \$3 at June 30, 2011 and 2010, respectively); interest at 3.3% to 5.5% paid semiannually on March 1 and September ; principal due in annual installments beginning 1994 through 2023 in varying amounts from \$185 to \$275, with annual mandatory sinking fund installments of \$290 to \$485 from September 1, 2004 through September 1, 2014 to retire \$3,775 of term bonds.	1,359	1,762
Bank of America- General Obligation Bond		
\$464 and \$497 at June 30, 2011 and June 30, 2010 respectively. Interest at 4.05% and principal due in quarterly installments of \$16 through March 31, 2022	463	497
	1,822	6,104
Less current portion	460	1,564
Long term portion of debt	\$ 1,362	\$ 4,540

Maryland Environmental Service
Notes to Financial Statements
June 30, 2011 and 2010
(In thousands except where noted)

(8) Debt (In Thousands) (continued)

Future minimum payments for long-term debt at June 30, 2011 are due as follows:

(In Thousands)	<u>Total</u>	<u>Principal</u>	<u>Interest</u>
Year ending			
June 30:			
2012	\$ 541	\$ 460	\$ 81
2013	543	487	56
2014	551	523	28
2015	54	40	14
2016	56	41	15
2017-2022	306	272	34
	<u>2,051</u>	<u>1,823</u>	<u>228</u>
Less unamortized bond discounts and deferred costs on refunding	(1)	(1)	-
	<u>\$ 2,050</u>	<u>\$ 1,822</u>	<u>\$ 228</u>

Water and Wastewater Facilities Certificate of Participation, 1991A Series, was issued in conjunction with the construction and acquisition of a water and wastewater facility at the Eastern Correctional Institution. The certificate represents proportionate interests in a related Conditional Purchase Agreement between the State, on behalf of the Department of Public Safety and Correctional Services, the Service and a trustee bank. The principal and the interest on the certificate shall be payable solely from the purchase installments made by the State and other pledged funds. In the event sufficient funds are not appropriated by the State, all title and interest in the facility shall be conveyed to the trustee and the State may be excluded from using the facility. The last bond payment was made on June 1, 2011. There is no outstanding balance on the bond.

The Cecil County Landfill Project – Lease Revenue Bonds, 2000 Series were issued in connection with acquiring, constructing and equipping an addition to the existing sanitary landfill owned and operated by the County Commissioners of Cecil County. The Series 2000 Bonds are special obligations of the Service, the principal of and the interest on which are payable solely from the revenues from the project and, to the extent provided in the indenture, the proceeds of the Series 2000 Bonds. Cecil County made a principal payment of \$460 on October 2010 and the remaining balance of \$2,730 on November 2010. There is no outstanding balance on the bond.

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 revenues from the landfill.

Maryland Environmental Service
Notes to Financial Statements
June 30, 2011 and 2010
(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, 2011, 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:

Long-term debt (including current portion) consists of the following at June 30, 2011:

Midshore Regional Landfill:

Midshore II Regional Landfill Project Revenue Bonds, Series 2011; February 2011

\$18,275 (plus bond premium of \$516); interest at 3.0% to 5.1% paid semiannually on May 1 and November 1; due in annual installments beginning 2012 through 2030 in varying amounts from \$600 to \$1,385.	\$ 18,791
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Hobbs Road Landfill Closure Project Water Quality Bond, Series 2011A; April 2011

\$2,000; interest at 1.1% paid semiannually in February and August; due in annual installments beginning 2012 through 2031 in varying amounts from \$90 to \$111	2,000
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Less: current portion	<hr style="width: 100%;"/> 690
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Long term portion of debt	<hr style="width: 100%;"/> <hr style="width: 100%;"/> \$ 20,101
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Maryland Environmental Service
Notes to Financial Statements
June 30, 2011 and 2010
(In thousands except where noted)

(8) Debt (In Thousands) (continued)

Midshore Regional Landfill:

Future minimum payments for long-term debt at June 30, 2011 are due as follows:

(In Thousands)

Year ending June 30:	<u>Total</u>	<u>Principal</u>	<u>Interest</u>
2012	\$ 1,525	\$ 690	\$ 835
2013	1,533	711	822
2014	1,535	732	803
2015	1,530	748	782
2016	1,532	774	758
2017-2021	7,671	4,356	3,315
2022-2026	7,663	5,433	2,230
2027-2031	7,663	6,831	832
	<u>30,652</u>	<u>20,275</u>	<u>10,377</u>
Plus: Unamortized bond premium	<u>516</u>	<u>516</u>	<u>-</u>
Total	<u>\$ 31,168</u>	<u>\$ 20,791</u>	<u>\$ 10,377</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 Mod-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, 2011 and 2010
(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, 2011 and 2010 (in thousands):

Maryland Environmental Service:

2011	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Advances from project participants	\$ 26,251	\$ 19,301	\$ (23,128)	\$ 22,424	\$ 20,543
Capitalized leases	9,601	-	(1,546)	8,055	1,242
Long term debt	6,104	-	(4,282)	1,822	460
Workers' compensation	2,362	42	-	2,404	373
Long term liabilities	<u>\$ 44,318</u>	<u>\$ 19,343</u>	<u>\$ (28,956)</u>	<u>\$ 34,705</u>	<u>\$ 22,618</u>

2010	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Advances from project participants	\$ 36,604	\$ 33,094	\$ (43,447)	\$ 26,251	\$ 23,999
Capitalized leases	11,206	-	(1,605)	9,601	1,545
Long term debt	7,565	-	(1,461)	6,104	1,564
Workers' compensation	2,125	237	-	2,362	366
Long term liabilities	<u>\$ 57,500</u>	<u>\$ 33,331</u>	<u>\$ (46,513)</u>	<u>\$ 44,318</u>	<u>\$ 27,474</u>

Midshore Regional Landfill :

2011	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Capitalized leases	\$ 754	\$ -	\$ (270)	\$ 484	\$ 250
Bond anticipation note	12,000	-	(12,000)	-	-
Long term debt	-	20,791	-	20,791	690
Landfill closure & post closure care	11,236	670	(2,719)	9,187	-
Long term liabilities	<u>\$ 23,990</u>	<u>\$ 21,461</u>	<u>\$ (14,989)</u>	<u>\$ 30,462</u>	<u>\$ 940</u>

2010	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Capitalized leases	\$ 1,012	\$ -	\$ (258)	\$ 754	\$ 270
Bond anticipation note	-	12,000	-	12,000	12,000
Landfill closure & post closure care	10,589	647	-	11,236	-
Long term liabilities	<u>\$11,601</u>	<u>\$12,647</u>	<u>(\$258)</u>	<u>\$23,990</u>	<u>\$12,270</u>

Maryland Environmental Service
Notes to Financial Statements
June 30, 2011 and 2010
(In thousands except where noted)

(9) Unrestricted Net Assets (In Thousands)

The Service's Board of Directors has designated its unrestricted net assets for the following purposes as of June 30, 2011 and 2010:

Significant designations as of June 30, 2011 and 2010, are explained as follows:

	2011	2010
Business research and development/contingency	\$ 5,515	\$ 5,794
Poplar Island Land Base	43	43
Equipment	1,057	1,083
Murden Memorial	7	7
Total designated unrestricted net assets	6,622	6,927
Undesignated unrestricted net assets	3,720	2,872
Total unrestricted net assets	\$ 10,342	\$ 9,799

(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 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 or Pension System prepares a separately audited

Maryland Environmental Service
Notes to Financial Statements
June 30, 2011 and 2010
(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 \$240 thousand and \$209 thousand, respectively, for the years ended June 30, 2011 and 2010.

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, 2011 and 2010 were \$2,152 thousand and \$1,836 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, 2011, management believes it is compliance with its obligations and has not violated the agreement. The loan forgiveness has been recognized as capital grant income in the accompany statement of changes in net assets for the year ended June 30, 2011.

(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 apportion 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, 2011. The landfill stopped accepting waste on December 31, 2010. Total closure and postclosure care costs for the landfill is currently estimated to be \$11,026 thousand, as determined through engineering studies and \$8,943 thousand and \$11,236 thousand has been recognized as a liability by the Service as of June 30, 2011 and 2010 respectively.

Midshore II current cells are approximately 2% filled as of June 30, 2011. Total closure and postclosure care costs for the landfill is currently estimated to be \$17,257 thousand, as determined through engineering studies and \$244 thousand has been recognized as a liability by the Service as of June 30, 2011. 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, 2011 and 2010
(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, 2010. The Service expects to satisfy these requirements as of June 30, 2011 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, 2011 and 2010 were \$5,278 thousand and \$5,197 thousand, respectively.

(15) Discontinued Operation

The Service remains obligated under certain facility leases. However, the facilities have been sublet to the new tenant under the existing terms for the remainder of the lease term.

(16) Segment Information

As detailed in Note 8, the Service issued revenue bonds and certificates of participation to finance certain projects in Maryland. Listed below is a description of each project, except for Midshore, whose financial statements are presented as a special purpose fund:

The Water and Wastewater Facilities Certificates of Participation, 1996 and 1991A Series, were issued in conjunction with the construction and acquisition of a water and wastewater facility at the Eastern Correctional Institution (ECI).

The purpose of the Garrett County Landfill Project (Garrett) is to provide a system for the disposal of solid waste in Garrett County. In connection therewith, the Service is contractually responsible for the construction, operation and maintenance of the Garrett County Landfill. The County has entered into a 20-year Waste Disposal Agreement with the Service for the disposal of solid waste generated within the County's boundaries. In accordance with the provisions of the Agreement, the Service has subcontracted with the County to operate the landfill. The Service financed the Project by issuing Landfill Project Revenue Bonds. Under the aforementioned agreements, the Service acts as lessor in a direct financing lease arrangement with the County. Therefore, the Service has not recorded the landfill's operations in these financial statements.

The Cecil County Landfill Project (Cecil) – Lease Revenue Bonds, 2000 Series, were issued in connection with acquiring, constructing and equipping an addition to the existing sanitary landfill owned and operated by the County Commissioners of Cecil County, including an additional landfill cell, a leachate collections system and certain site improvements located in Cecil County, Maryland. The County will lease the site of the Project, including all necessary access easements, to the Service for a term equal to the term of the Series 2000 bonds.

Maryland Environmental Service
Notes to Financial Statements
June 30, 2011 and 2010
(In thousands except where noted)

(16) Segment Information (continued)

Under the aforementioned agreements, the Service acts as lessor in a direct financing lease arrangement with the County. Therefore, the Service has not recorded the landfill's operations in these financial statements.

The investors in the bonds and certificates rely solely on the revenues generated by the individual project for repayment.

All project costs are to be borne by the project participants. Therefore, net assets are generally zero.

Projects do not maintain separate bank accounts for the receipt and disbursement of operating revenues and expenses. All cash transactions are processed by the Service and the difference between funds received and expended are recorded as due to or due from project participants.

Summary financial information by project follows:

(a) Condensed Statements of Net Assets – by Project

Condensed Statements of Net Assets						
As of June 30, 2011 and 2010						
<i>(Expressed in Thousands)</i>						
	Cecil		Project ECI		Garrett	
	2011	2010	2011	2010	2011	2010
Assets						
Current assets	\$ -	\$ 505	\$ 2	\$ 665	\$ 2,051	\$ 2,072
Capital assets (net)	-	-	-	-	-	-
Other assets	4	2,736	-	163	566	951
Total assets	4	3,241	2	828	2,617	3,023
Liabilities						
Current liabilities	4	496	2	669	455	442
Other liabilities	-	2,745	-	159	2,162	2,581
Total liabilities	4	3,241	2	828	2,617	3,023
Net Assets						
Invested in capital assets, net of related debt	-	-	-	-	-	-
Unrestricted net assets	-	-	-	-	-	-
Total net assets	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -

Maryland Environmental Service
Notes to Financial Statements
June 30, 2011 and 2010
(In thousands except where noted)

(16) Segment Information (continued)

(b) Condensed Statements of Revenues, Expenses and Changes in Net Assets – by Project

Condensed Statements of Revenues, Expenses and Changes in Net Assets						
For the years ended June 30, 2011 and 2010						
<i>(Expressed in Thousands)</i>						
	Cecil		Project ECI		Garrett	
	2011	2010	2011	2010	2011	2010
Operating Revenue: Charges for services	\$ 64	\$ 177	\$ (92)	\$ (623)	\$ 148	\$ 173
Operating expenses:						
Salaries and benefits	-	-	-	-	33	35
Other	-	-	(137)	(706)	28	(49)
Depreciation	-	-	-	-	-	-
General and administrative	-	-	-	-	11	12
Total operating expenses	-	-	(137)	(706)	72	(2)
Operating income	64	177	45	84	76	175
Nonoperating expenses, net	(64)	(177)	(45)	(84)	(76)	(95)
Change in net assets	-	-	-	-	-	80
Net assets, beginning of year	-	-	-	-	-	(80)
Net assets, end of year	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -

(c) Condensed Statements of Cash Flows – by Project

Condensed Statements of Cash Flows						
For the years ended June 30, 2011 and 2010 (In Thousands)						
<i>(Expressed in Thousands)</i>						
	Cecil		Project ECI		Garrett	
	2011	2010	2011	2010	2011	2010
Net cash provided by operating activities	\$ 716	\$ 169	\$ 710	\$ 703	\$ 68	\$ 88
Net cash used by capital and related financing activities	(716)	(177)	(710)	(703)	(118)	(139)
Net cash provided by investing activities	-	8	-	-	50	51
Net increase (decrease) in cash and cash equivalents	-	-	-	-	-	-
Cash and cash equivalents - beginning of the year	-	-	-	-	-	-
Cash and cash equivalents - end of the year	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -

**Maryland Environmental Service
Required Supplemental Information for Other Postemployment Benefit Plan
June 30, 2011**

**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>
January 1, 2009	\$ -	\$ 3,015	\$ 3,015	0%	\$ 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>Year Ended</u>	<u>Annual Required Contribution</u>	<u>Percentage Contributed</u>
2011	\$313	100%
2010	\$313	227%



**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 the basic financial statements of the Maryland Environmental Services (the Service) as of and for the year ended June 30, 2011, and have issued our report thereon dated September 28, 2011. 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 of America.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Services' internal controls over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Services' internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Services' internal control over financial reporting.

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 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.

Our consideration of the 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 deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weakness, as defined above.

Compliance and Other Matters

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



SB & COMPANY, LLC
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This report is intended solely for the information and use of management, the Board of Director, Federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

SB & Company, LLC

Hunt Valley, Maryland
September 28, 2011



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