



2013
ANNUAL REPORT



MARTIN O'MALLEY GOVERNOR OF MARYLAND

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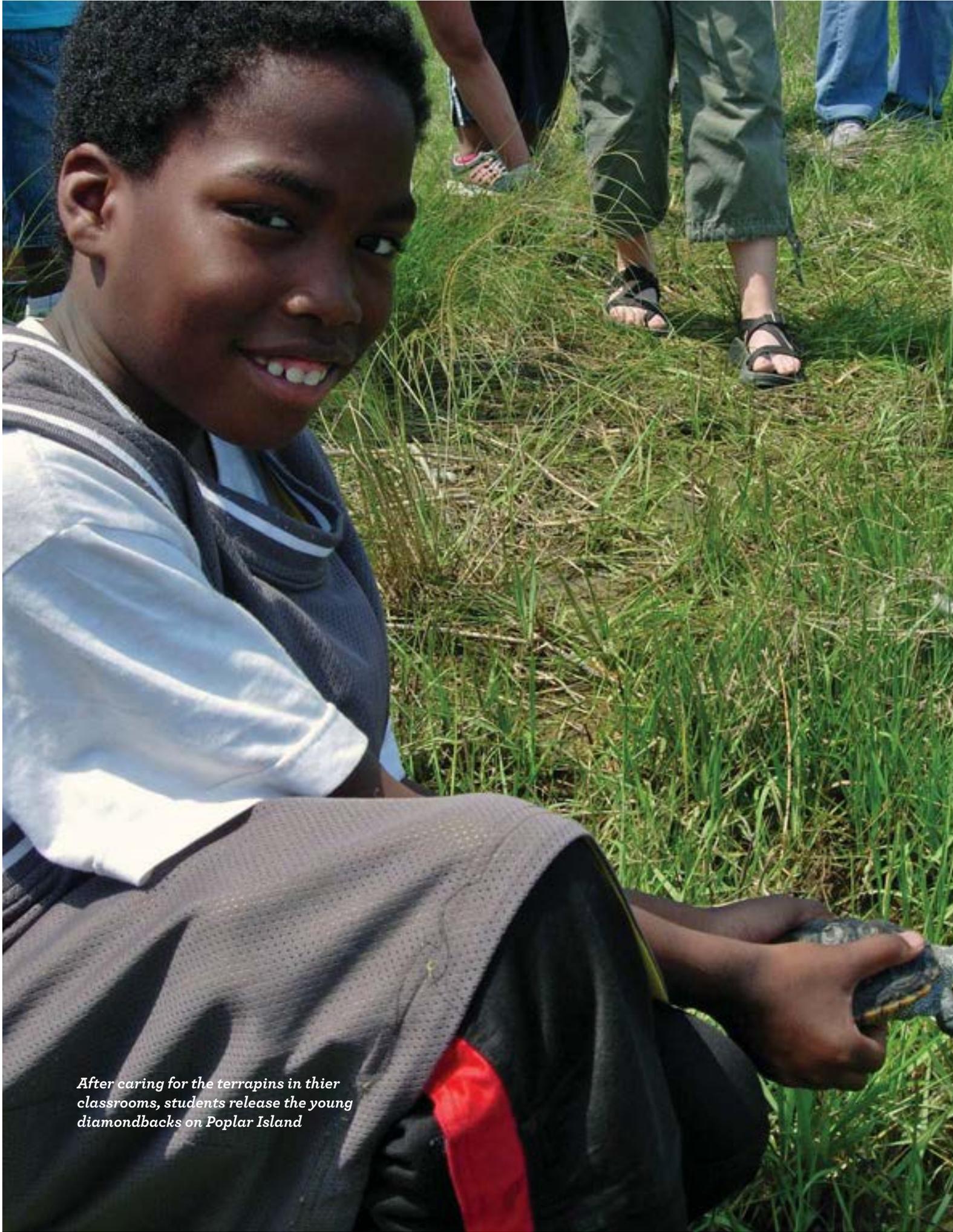
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After caring for the terrapins in thier classrooms, students release the young diamondbacks on Poplar Island

Director's Letter

During fiscal year 2013, all levels of government continued to deal with the slow pace of our economic recovery. Our customers still face the challenge of budget reductions and low revenues.

The resulting decrease in contractual purchasing by our clients led to a revenue decrease of nearly 11 percent. However, even with the loss of this pass-through revenue, our overall efficiency and focus on a well-managed business led to an increase in retained earnings. Our Net Position increased by about \$870,000.

The year saw a moderate increase in hiring at sites throughout the Service, including more jobs at Baltimore County's Central Acceptance Facility as construction finished on an improved transfer station for handling residential and commercial solid waste. The site also saw the installation of a new state-of-the-art single stream recycling system, designed to process Baltimore and Harford County recyclables.

Throughout difficult economic times, MES financial results remain solid, a testament to our commitment to providing low-cost solutions for our customer's environmental issues. Our employees understand the important role they play in protecting Maryland's land, air and water. Their dedication to creative problem solving, excellent customer service and workplace safety keeps our agency strong.



James M. Harkins
Director



Concrete reef balls create a marine habitat at the Swan Creek wetlands, adjacent to the Cox Creek Dredged Material Containment Facility



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, storm water services and renewable energy. We provide expert engineering, monitoring and inspection services.

With 853 diverse projects located in three states, ranging in cost from \$720 to \$6.2 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.



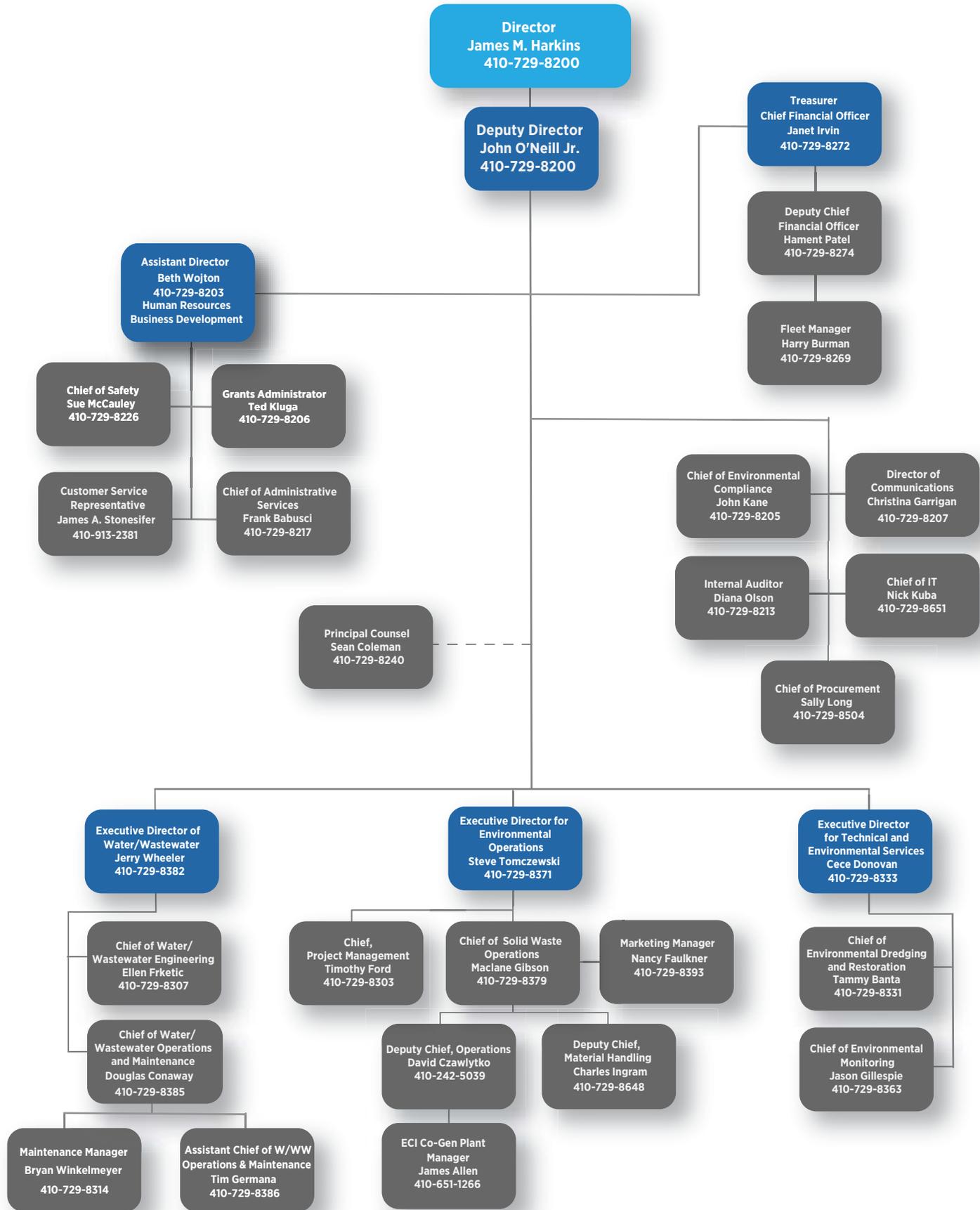
The LEED Program - Leadership in Energy and Environmental Design - emphasizes state-of-the-art strategies for sustainable site development, water savings, energy efficiency, materials selection and indoor environmental quality. As part of our commitment to the environment, MES chose the LEED criteria 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, making us Maryland's first State government building with operations and maintenance practices certified to LEED standards. The building was recertified Gold in 2013.





Restoring Poplar Island with dredged materials. MES is the largest creator of wetlands in Maryland.

TECHNICAL AND ENVIRONMENTAL SERVICES

ENVIRONMENTAL DREDGING AND RESTORATION

The Maryland Port Administration (MPA) is responsible for ensuring placement capacity for the material dredged from the shipping channels running through the Maryland portion of the Bay, the Patapsco River and Baltimore Harbor; regular dredging is required to provide safe and clear passage for cargo vessels. The MES Environmental Dredging & Restoration Division supports the Port's mission by providing services in the field of dredged material management with an emphasis on environmental restoration, innovative re-use of dredged material, and planning, permitting, monitoring, reporting, operating and maintaining dredged material placement sites.

MES provides hazardous material and site management support for the MPA and Honeywell at the Hawkins Point Hazardous Waste Landfill and for MPA at the Dundalk Marine Terminal. MES also provides environmental management system services and environmental compliance for the MPA at the Dundalk Marine Terminal.

In addition, MES provided environmental support in 2013 to the Maryland Department of Natural Resources Fisheries Service, Boating Service and Watershed Service, the Maryland Department of Agriculture and the USACE Philadelphia District.

MES continued to perform wetland delineation, wetland mitigation, wetland permitting and forest conservation planning services throughout the year to the MPA, Dorchester County, Charlotte Hall Veterans Home in Charlotte Hall, MD and the Southern Pre-release Unit in Hughesville, MD.

MES works directly with Eastern Shore schools through the TERP Program (Terrapin Education and Research on Poplar) to raise diamondback terrapins in classrooms. During the 2012-2013 school year, 12 teachers from nine schools raised 22 terrapins. In spring 2013, 222 terrapins raised through Arlington Echo, the National Aquarium and MES' TERP program were released on Poplar Island.

During FY 2013, over 7,859 participants, including 3,954 students, learned about the Port of Baltimore, the importance of dredging and environmental restoration work through MES outreach events.





Volunteers plant grasses on Poplar; Students release young diamondback terrapins

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. Poplar Island was once a 1,000-plus acre island with a thriving community. Over the years the island slowly eroded away, leaving only three small remnant islands.

Today, clean dredged materials are used to rebuild the island and its upland and wetland habitats. To date, more than 24.6 million cubic yards of dredged material has been deposited in the island. Poplar Island is now recognized as a valuable nesting and nursery area for many species of wildlife, including eagles, osprey, heron and diamondback terrapins, while providing millions of cubic yards of dredged material placement capacity.

In 2013, the Poplar Island Restoration Project continued its filling and wetland construction phase. Work continues on the design phase of the Poplar expansion, which was initiated in 2012. Upon completion, the expanded ecosystem restoration project in Talbot County will be

approximately 1,696 acres in size, with 709 acres of wetland, 858 acres of upland and 130 acres of open-water embayment habitat. MES operations, maintenance, monitoring and development at Poplar are expected to continue through at least 2036.

COKE POINT

As part of MPA's planning for the next phase of dredged material management, MPA has asked MES to manage the National Environmental Policy Act (NEPA) processes and environmental permitting for a new dredged material containment facility (DMCF) at Coke Point in Baltimore.

MPA is currently negotiating to purchase the Coke Point property. Completion of the NEPA requirements will culminate in permitting what MPA hopes to become the next facility in their long-term plan for dredged material management. Coke Point will require on-site remediation in addition to the construction and development of the facility. MES looks to maintain and advance our partnership with MPA at this important site.



Swan Creek habitat restoration project at Cox Creek DMCF

HART-MILLER ISLAND

MES has operated and maintained Hart-Miller Island (HMI) 1,140-acre dredged material containment facility since 1984. HMI, a project that began in controversy, has become a model of successful collaboration between government and citizens. HMI now serves as a valuable habitat for shore and water birds and an outstanding recreational site for boaters.

Over 25 years, more than 100 million cubic yards of dredged material was placed at HMI; the last placement occurred in 2009. MES will continue to provide operations, maintenance and environmental monitoring support to the project. MES works with the Maryland Port Administration, DNR and the design team to develop cost effective approaches to transform the North Cell into viable wildlife habitat. The current North Cell design concept is based on upland habitat with a storm water management pond and perched, non-tidal wetlands. The goal is to complete the major construction of the North Cell habitat within a five-year time frame.

COX CREEK

After the closing of Hart-Miller Island on December 31, 2009, the Cox Creek and Masonville DMCFs became the remaining two options for placement of Harbor dredged material. MES operates the 133-acre Cox Creek site for the MPA. Cox Creek received its first large federal contract for approximately 433,000 cubic yards of Harbor dredged material in October 2012. To date, Cox Creek has received 1,419,574 cubic yards of material.

During 2013, MES continued to upgrade the existing spillway systems with unloader recirculation access and exterior dike vaults to house flow meters. The flow meters will provide accurate discharge volumes used to calculate the total maximum daily loads (TMDL) required in the new permit.

As placement facilities reach capacity, innovative reuse of dredged material gains importance. Cox Creek is a potential future home for innovative reuse activities for MPA.



Masonville DMCF

MES also manages the Swan Creek wetlands adjacent to Cox Creek. This wetland is an 11.13-acre habitat restoration project that includes 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 DMCF construction, mitigation and enhancement project for MPA. MES completed the exterior dike construction for the Masonville Dredged Material Containment Facility (DMCF) in 2010 and the interior landside dike construction in early 2012. Masonville is a 141-acre facility partially bordered with fringe wetlands with 130 acres of open water contained by sand dikes, interior leachate barrier, exterior armor stone and a cofferdam cell bulkhead.

Construction of two spillway structures and diffuser outlet pipes was completed in May 2011. Flow meters tracking discharge volumes were added to the system in 2012. The discharge permit for the site was received in November 2010 and the first inflow began that same month. To date, the containment facility has received over 374,842 cubic yards of harbor material.

As part of the DMCF construction project permitting, MES is designing and constructing the mitigation elements of the project, including enhancement of the 52-acre Masonville Cove area adjacent to the new DMCF facility with wetlands, living shorelines, a community education center and walking trails.

Enhancement of the central portion of Masonville Cove uplands (approximately 12 acres) was completed in 2012 and opened to the public in October of that year. Local residents now have access to the Patapsco River at Masonville Cove via two new piers constructed in 2011 - a fixed boat pier and a floating pier for kayaks and canoes. MES construction of uplands enhancement continued in



Masonville Cove Urban Wildlife Refuge; Volunteers plant grasses on the Masonville shoreline.

2013 in the second phase of the Cove (approximately 24 acres). The first phase of Cove substrate improvement (approximately four acres) was completed in 2010 and 635 reef balls produced by MES were placed in the completed areas in 2012. In 2013, Masonville Cove was designated by the USFWS as the first Urban Wildlife Refuge Partnership in the Nation.

The Masonville Cove Environmental Education Center hosts a variety of programs to enrich the community. The Center is a near-zero net-energy building with a ground source HVAC system and solar energy power. The center, constructed by MES and their subcontractor, Baltimore Green Construction, 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 education programs at the center. These activities expanded into the Masonville Cove campus area in Fall 2012, following the grand opening to the public, and continued into 2013.

In 2013, The U.S. Fish and Wildlife Service designated Masonville Cove in Baltimore as the nation's first Urban Wildlife Refuge Partnership. With 80 percent of Americans living in cities, the Service's new Urban Wildlife Refuge Initiative will forge connections between the National Wildlife Refuge System, natural resource conservation, and people living in metropolitan areas.

"National wildlife refuges are the best of American's wild places, but they are mostly in rural areas. Too many Americans have grown up without a real connection to the outdoors and wildlife. This initiative gives us the chance to change that," said U.S. Fish and Wildlife Service Director Dan Ashe in his announcement.

The U. S. Fish and Wildlife Service, National Fish and Wildlife Foundation and The Chesapeake Bay Trust will dedicate a total of \$55,000 in support of the partnership.

The Urban Wildlife Refuge Initiative grows out of the Service's Conserving the Future vision, which set a strategic path for the National Wildlife Refuge System for the next decade and beyond.





Masonville Environmental Education Center; piers at Masonville welcome boats, kayaks, fishermen, and outdoor enthusiasts.

HARBOR TEAM

MPA has asked MES to continue working with stakeholder groups on the future dredged material placement options that were identified in the 2011 Harbor Team Report. In accordance with the Harbor Team Report, MES is assisting the MPA with the initial feasibility level studies on an expanded dredged material containment facility at the existing Cox Creek DMCF.

DASHBOARD

MES works with MPA Harbor Development to improve the ProjectWise file management system that streamlines document sharing within MPA and allows MES to send document updates directly to the Harbor Development file sharing site. In addition, MES has completed an Executive Dashboard that assists with the communication of high level project status and

budget information within MPA. MES works to enhance the Dashboard and will be updating the map viewer application and creating virtual tours of the Dredged Material Containment Facilities.

DNR FISHERIES MANAGEMENT

MES has provided technical and administrative support to the Maryland Department of Natural Resources (DNR) in several service areas over the last 40 years.

In 2013, MES assisted DNR Fisheries Service by providing technical support for the expanded Maryland Aquaculture Program. In addition, MES provides employees to support DNR programs. MES has also developed proposals to provide technical support to the Oyster Restoration Program and the Commercial Fisheries Electronic Reporting Program.



Maryland Environmental Service samplers travel the State collecting water samples for approximately 180 water and wastewater facilities. We sample over 1000 monitoring wells per year.

HAWKINS POINT HAZARDOUS WASTE LANDFILL

MES operates and manages the Hawkins Point Hazardous Waste Landfill, a long-standing project with the Maryland Port Administration and Honeywell. Services include: routine post-closure care, leachate management and leachate disposal in accordance with the EPA RCRA Corrective Action Permit and MDE Controlled Hazardous Substance (CHS) permits. Both permits were successfully obtained in 2013. MES also provides routine groundwater monitoring as directed by our CHS permit, report writing and regulatory coordination with EPA and MDE.

DUNDALK MARINE TERMINAL

MES operates and maintains the groundwater treatment plant at Dundalk Marine Terminal (DMT) for the Maryland Port Administration; manages all hazardous

and non-hazardous waste associated with the chromium contamination at DMT; and provides sampling and report writing services for the NPDES permit.

ENVIRONMENTAL MANAGEMENT SYSTEM SERVICES

MES has assisted MPA with their Environmental Management Plan (EMS), including ISO 14001 certification, since 2007 by providing on-site staff to implement and maintain the MPA EMS and assist with regulatory compliance. Our services include asbestos management, industrial hygiene support, assistance with MPA air quality initiatives, stormwater pollution prevention inspections and reporting and TMDL planning and implementation assistance.



Baltimore/Washington International Thurgood Marshall Airport

ENVIRONMENTAL MONITORING

Expert environmental monitoring protects our air, land and water. It also ensures our clients comply with complicated regulations and avoid costly violations. The TES Environmental Monitoring Division conducts comprehensive program management of environmental inspections; sampling and reporting; facility and system operations and maintenance; strategic planning and remediation services to preserve these resources for the residents of Maryland. Division services include:

- Stormwater Inspections, Maintenance & Reporting
- Airport Operations & Maintenance Support
- Facility, Structure & Equipment Inspections & Maintenance
- Lead and Asbestos Abatement
- Energy Audits
- Environmental Audits
- Laboratory Analysis
- Sample Collection
- NPDES Compliance Reporting

- Website & Application Development
- GIS Services
- Regulatory Liaison
- Monitoring Services
- Public Outreach and Environmental Training
- NEPA Compliance and Environmental Planning
- Geotechnical Investigation

BALTIMORE/WASHINGTON INTERNATIONAL THURGOOD MARSHALL AIRPORT

MES provides the Maryland Aviation Administration with around the clock coverage and emergency response at BWI Thurgood Marshall Airport and Martin State Airport. Our employees help keep both airports operational on a daily basis, including weather and other emergencies.

MES collects glycol runoff and maintains the airport's deicing fluid collection system. 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. MES collects stream



Stormwater work for the Maryland Department of Transportation

samples continuously during the de-icing season to ensure Maryland Aviation Administration environmental compliance.

MES employees also inspect and maintain water, wastewater and stormwater systems at both BWI and Martin State Airport.

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.

As part of its services to the MDOT Modals, MES is developing and administering an expanding environmental program with SHA's Office of Environmental Design. The Service has assisted multiple SHA Divisional Offices with compliance, organization and expansion of its environmental programs since 2003.

MES supports SHA with a variety of new services that include Chesapeake Bay Total Maximum Daily Load (TMDL) Implementation, Stormwater Management Pond Sediment Sampling and Stormwater Management Pond Boring Installation, IDDE Sampling & Investigations, Geotechnical Assessments and Geophysical Assessments.

MES continues to perform stormwater inspection and maintenance services at MDOT, MAA, MVA and MDTA Facilities across the State. The required maintenance ranges from vegetation control and grading to the installation of required stormwater structures.

MES actively supports the extensive stormwater programs for each agency, providing services ranging from inspections and the creation of Best Management Practices (BMPs) to rehabilitation, traffic control and



MES Sub-Surface Investigation Training grads; Wetland delineation services

corrective actions. MES has also created stormwater inventory maps of several State Agency Facilities using GIS technology.

By acquiring additional training and certification, Environmental Monitoring staff are expanding MES services available to the Maryland Department of Transportation. MES employees attended Sub-Surface Investigation (SSI) Certification training in 2013. Taught by instructors approved by the National Highway Institute (NHI), the course is intended for drillers, drilling inspectors, engineers, geologists and technicians involved in field data collection and quality assurance of subsurface investigations.

The course follows Federal Highway Administration (FHWA) guidelines and practices for subsurface investigations and many states now require this qualification to work on U.S. Department of Transportation (DOT) projects. A partial list of topics addressed in the course include exploration equipment and methods; safety; borehole sealing; drilling and sampling requirements and criteria; proper soil and rock visual classification and descriptions; common drilling errors; and dealing with difficult subsurface site

conditions. A two-hour qualification exam is administered at the end of the course. All eight MES employees passed the course and are now NHI Certified.

In 2013, MES began providing a full time on-site Sustainability Planner for the Maryland Transit Administration (MTA) - responsible for coordinating bicycle, pedestrian and electric vehicle charging planning efforts. MES also provides part-time GIS services and a full time architectural historian at MTA headquarters. In addition, we will be providing full time on-site National Environmental Policy Act (NEPA) services and a Park-and-Ride specialist to MTA.

WORK WITH MEMA

The Maryland Emergency Management Agency ensures Maryland families, communities and key Agencies have the tools they need to prepare for, mitigate against, respond to and recover from the consequences of emergency and disaster events. In 2013, MES began working with MEMA, providing procurement assistance and on-site project management for their State Emergency Operations Center (SEOC) Renovation project. In addition, MES GIS staff provide a variety of technical and consulting services



Mount St. Mary's University solar farm in Emmitsburg - recognized as Best Solar Project 2012. MES provided technical assistance for the permitting requirements of the project.

as directed by MEMA, including the facilitation of grant application submissions, development of an online grant management system, conducting preliminary damage assessments, development of a Maryland flood forecasting system and GPS mapping for repetitive flood loss.

RENEWABLE ENERGY PROGRAM

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

MES is the lead State agency for the construction of an anaerobic digester on Maryland's Eastern Shore that will provide much needed renewable power and remove excess nutrients from the Chesapeake Bay watershed. The digester will be located on property owned by the Maryland Department of Public Safety and Correctional Services.

We are helping State agencies explore options for expanding renewable energy use, including conducting a

renewable energy assessment at Maryland Transportation Authority locations statewide. Other energy projects include a solar feasibility assessment for the City of Bowie and managing the Residential Anemometer Program for the Maryland Energy Administration. The anemometer program requires installation of wind gauges and analysis of data to determine feasibility for homeowners to install wind turbines on their property. In Harford County, MES is working with the Agricultural Co-op to install and monitor anemometers on area farms

GEOGRAPHIC INFORMATION SYSTEM (GIS) SERVICES

MES services help the State government efficiently organize, plan and implement multi-agency environmental 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.

With continually expanding capabilities and technological improvements, including enhanced data collection and data sharing services (particularly between agencies), interactive mapping and customized reporting, MES is a leading resource in Maryland for GIS and application development.



MES GIS staff use technology to support cross-agency environmental projects

MES GIS provides important data support to: 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 is currently working with the Maryland Department of the Environment to improve National Pollutant Discharge and Elimination System (NPDES) reporting and data submission processes. This effort will help MDE assess MS4 permit compliance, better model Total Maximum Daily Loads (TMDLs) and monitor Chesapeake Bay Program progress and stormwater Wasteload Allocations (WLAs).

As a part of this project, MES is helping MDE develop a new GIS-based submittal process that includes: new geodatabase design, tools to assist permit holders with data submission and review, as well as tools to assist

MDE with reporting and data management. This project will enable MDE to seamlessly integrate the NPDES Annual Report and associated information into a single, comprehensive data format. This project is estimated to be completed by March 2014.

The Watershed Resources Registry (WRR) was created to streamline information collection and preparation for permit processes, prioritize watershed needs and help stakeholders use limited resources to achieve multiple environmental goals. Currently, there are eight different types of Restoration and Preservation GIS-based data layers that were created to target Stormwater, Wetland, Upland and Riparian mitigation opportunities.

MES worked closely with members of the WRR Technical Advisory Committee, which is comprised of various federal, State and local partners, to provide a suite of services, including: analytic analyses, modeling, data qa/qc, website development, GIS-based web application development, hosting, training and outreach support.



Stormwater maintenance - before and after

REGULATORY & PERMIT OVERSIGHT

MES helps clients meet all of their environmental regulatory requirements. MES assists MDOT, MAA, MVA, MDTA and SHA remain in compliance with their respective NPDES or Municipal Separate Storm Sewer System (MS4) General Permit through permit review and program development/implementation. In addition, MES performs field inspections, monitoring, operations and maintenance and provides regulatory reporting to MDE.

MES STORMWATER SERVICES

With over 150 stormwater specialists on staff, MES routinely provides stormwater and TMDL technical services across the State.

MES offers life-cycle stormwater expertise including:

- BMP assessment and planning,
- stormwater BMP inspection,
- wet-weather compliance sampling,
- laboratory analysis and compliance reporting,
- BMP installation,

- sediment removal and erosion control preventative maintenance and
- customized compliance and inspection tracking applications.

MES also prepares Stormwater Pollution Prevention Plans (SWPPP) , Spill Prevention, Control, and Countermeasures Plans (SPCC) and performs quarterly and annual stormwater inspections for numerous State and privately-owned wastewater treatment plants. MES personnel are certified by both Maryland Department of the Environment and the State Highway Administration in Sediment and Erosion Control (Green and Yellow Cards). MES maintains compliance and legal staff well versed in TMDL and NPDES compliance and determining impacts resulting from upcoming regulatory changes.

MES staff work on-site at MDE to assist in permit review and provide support to the permit writers. MES staff are currently developing the process and application for MDE for submittal of the MS4 annual reports required by new regulatory requirements.



Students visit archaeological digs in New Market. MES staff oversee archeological sites, often a critical element of environmental permitting, on behalf of the State Highway Administration.



Maryland Correctional Institution, Hagerstown

WATER AND WASTEWATER

At parks, hospitals, prisons and other institutions, MES serves as the 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 provide service 24/7 to correct treatment plant problems.

In parts of Maryland located 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, developers and homeowner associations to insure that small-scale treatment systems meet the most current treatment and regulatory requirements and that they are staffed by qualified licensed operators.

With years of experience in the operation of all types of facilities, we understand the administrative and technical requirements necessary to provide a safe water supply and keep wastewater discharge meeting federal and State requirements.

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.

At this time the following facilities are either in the design or construction phase:

- Freedom District WWTP in Carroll County – under design with construction to start in July 2014;
- Maryland Correctional Institution WWTP in Hagerstown – under design with construction to start in 2015;
- Eastern Correctional Institution WWTP in Somerset County - Design is scheduled to start in November 2013. This project consists of an upgrade that will meet an extremely stringent discharge permit that goes beyond ENR levels of treatment and provides additional treatment capacity and process redundancy. The upgrade will also provide a system to treat the water plant's reverse osmosis reject water;



Dorsey Run Wastewater Treatment Plant

- Dorsey Run WWTP – This plant is over 25 years old and was essentially designed to meet a BNR level of treatment. However, due to its age, a project was just completed that provided equipment replacement and/or renovation and electrical and control system upgrades. Since the completion of that project, and in coordination with funding from MDE, an engineering firm was hired to evaluate possible treatment system enhancements that could be made to the plant to make it even more efficient and fully capable of meeting or exceeding an ENR level of treatment. The ENR upgrades will allow the plant to more reliably discharge 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 was significant enough to reduce plant treatment capacity and

prevent additional connections, thereby jeopardizing the fulfillment of smart growth initiatives and the utilization of existing infrastructure. MDE asked MES to investigate and determine the extent of I/I throughout the State.

The first phase of the project consisted of analyzing flow records and other data from 45 systems, which provided a broad-brush determination of the extent of I/I in Maryland. Upon completion of this work, MES performed 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 determine the costs to make system improvements and repairs 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:

- Review Results from Any Prior I/I Studies
- Analyze Monthly Operating Records (MORs)
- Gather System As-Built or Construction Drawings
- Inventory, Inspect, and Map System



Frostburg Water Treatment Plant

- Develop a GIS Map of System Components
- Perform Flow Monitoring
- Smoke Test the System
- Perform Closed Circuit Television (CCTV) Inspection
- Prepare Cost Estimates for Needed Corrective Actions and System Improvements
- Develop Capital Improvement Plan

Individual reports were prepared for each of the five systems evaluated and submitted to MDE. The reports were also given to the municipalities so they can implement the Capital Improvement Plan and make the needed repairs and improvements to reduce their I/I.

In 2012, after completing the five system investigations, a final project report was prepared which contained each of the individual system reports along with a summary of the findings and how the results are extrapolated statewide. The following is a list of some of the notable findings:

- The average daily amount of I/I ranged from 18 percent to 28 percent of the system's average daily

flow with an average of 22 percent. Daily and hourly peak amounts of I/I were much higher and as much as four times the average daily flow.

- The average daily flow per equivalent dwelling unit (EDU) was 310 gal/day/EDU. After adjusting this value to remove the I/I portion, the value becomes 241 gal/day. The adjusted number is similar to MDE's planning number of 250 gal/day/EDU.
- The estimated costs to correct defects and make other improvements to reduce I/I flows for the systems ranged from \$400,000 to \$24 million.
- Extrapolating these costs to the 45 systems that were evaluated in Phase I gives a total cost of \$800 million. Although this cost is high, it does not include the other 100+ systems in Maryland that were not included in Phase I, along with the large collection systems in the City of Baltimore, suburban Washington, DC and the other large county systems.



Cambridge Wastewater Treatment Plant

The results of the study show that I/I is a problem plaguing all systems and will only get worse as the sewer lines age. Additionally, the need to address I/I is becoming even more critical as more sophisticated Enhanced Nutrient Removal (ENR) WWTP treatment processes are used, which are more susceptible to upsets from high I/I flows.

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 Wastewater Treatment Plant. These services include planning, development of nutrient management plans, inspections, 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.

As a program participant, plants earn capacity payments for being on-call to respond when demand response events occur and earn energy payments when they actually respond to an event.

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.



Elk Neck State Park; Susquehanna State Park

CAPITAL IMPROVEMENT PLANS

MES prepared a comprehensive Statewide Water and Wastewater Master Plan which lays out the needed capital improvements for all State owned water and wastewater treatment plants. The steps taken to prepare the plan included reviewing each facility's operating and performance records, performing a condition assessment of each facility to determine what improvements may be needed, developing a concept plan and scope for the identified improvements, cost estimates, ranking the individual projects and developing a comprehensive CIP funding schedule and projection for the next five to 10 years.

The CIP assessment includes not only determining what improvements are needed due to deteriorated infrastructure, but also anticipates what improvements or upgrades may be needed to meet known or more stringent regulatory requirements.

To allow ranking and prioritizing the CIP projects, MES developed a "Project Ranking Methodology" which consisted of assigning points based on the following criteria:

- Compliance & Permits (e.g., permit violations, anticipated more stringent limits, etc.)
- Health and safety
- Structural issues
- Impact on operating and maintenance costs
- Operational deficiencies
- Energy and environment (energy savings and environmental benefits)

The completed Master Plan was submitted to the State Legislature and funding agencies to provide the basis for appropriation of funds for the needed CIPs. The plan is updated every five years.



Videoray equipment allows remote water tank inspections

STATEWIDE WATER/WASTEWATER MAINTENANCE

MES Maintenance employees are strategically located throughout Maryland, ready to quickly respond to emergencies. In addition to providing repair and maintenance services for water and wastewater equipment, MES also has a generator repair and service program, as well as an expert water tank team who can provide complete tank services, including:

- Performing tank inspections and evaluations and submitting a report that describes the condition of the tank and the needed repairs and rehabilitation,
- Preparing tank repair and reconditioning specifications,
- Performing metal thickness testing,
- Underwater dive and robotic inspections with VideoRay, a remote operated vehicle,
- Paint failure analysis,
- Lead paint and hazardous material testing,
- Disinfection and chlorination,
- Testing for levels of volatiles organic compounds (VOCs) and other bacteria and water quality testing,
- Inspection and quality assurance of repair, cleaning and painting operations and
- New tank design, bidding and construction management.



Montgomery County Recycling Facility; Yard Waste Composting

ENVIRONMENTAL OPERATIONS

From an award-winning regional landfill on the Eastern Shore to a 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

In Montgomery County, MES operates a recycling facility that processed 29,283 tons of commingled recyclables in FY 2013. MES also provides recycling tours and educational programs for schoolchildren and citizens.

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.

BALTIMORE COUNTY CENTRAL ACCEPTANCE FACILITY

MES has operated the Central Acceptance Facility (CAF), formerly known as Baltimore County Resource Recovery Facility (BCRRF), in Cockeysville since 1990. The facility serves the needs of Baltimore County residents in the areas of solid waste transfer and single stream recycling processing and provides a convenient homeowner drop-off center for general solid waste and recyclable materials.

Forty-three MES employees staff the facility. In FY 2013, a total of 215,765 tons of trash was transferred through the CAF. A major replacement of the outside transfer station (TAF) occurred in FY 2013, providing for the installation of a two-tunnel, open-top transfer trailer system which dramatically improved the transfer efficiency. The new transfer station will accommodate two tractor-trailer trucks simultaneously. Each tunnel used for loading residential and municipal solid waste is equipped with in-ground axle scales. The Project cost approximately



Construction of new transfer station and recycling operations at Baltimore County's CAF

\$8 million, with MES being responsible for the design, construction and management of the work. The TAF construction project was completed in June 2013.

The other major construction project at the CAF began in the Spring of 2013 - installation of a new state-of-the-art, single-stream recycling process designed by Bollegraaf Technologies, within the existing CMRF building on the site. MES provided the construction management for this \$15 million project, which was approximately 60 percent complete at the end of June 2013. The system was completed and operational in November 2013. It has the capacity to process 42 tons per hour of single stream material and will handle all of Baltimore County and Harford County's single-stream generation, based on a 10-hour per day, 5-day schedule.

MES will provide employees to operate the facility and provide marketing for all recycled commodities generated by the facility. Areas of the existing CMRF will be converted into a warehouse/shipping facility to house the bales of commodity material generated by the new single stream facility awaiting shipment to various markets.

While the new facility was in construction, 40,886 tons of single stream recyclables were transferred through the CAF to a processing facility in Elkridge, MD.

MIDSHORE RECYCLING

MES manages the Midshore Recycling Program for Caroline, Kent, Queen Anne's and Talbot Counties. Since beginning management of the program, MES has built commodity consolidation bunkers at Midshore II Landfill, optimized collection routes for maximum efficiency, instituted improved safety procedures, and competitively bid the recyclable commodities. MES purchased 100 new eight-yard recycling containers to replace the aging collection "igloos," as well as two new front-end collection vehicles to collect cardboard, paper, plastics and cans from the 43 Midshore Recycling sites. This new equipment has served to increase collection efficiency as well as minimize collection site issues, i.e. limited availability, with the old igloo collection crane trucks. However, glass continues to be collected utilizing the old igloo system and crane trucks.



Montgomery County's Yard Waste Facility in Dickerson achieved ISO 14001 certification in 2013 for its environmental management system.

YARD WASTE COMPOSTING

MES is one of the largest composters in the State of Maryland. The agency operates yard waste composting facilities in both Prince George's and Montgomery County. In Prince George's County, the Western Branch Composting Facility processes yard waste - including grass, leaves, brush and Christmas trees - from approximately 158,000 households. At the site, the yard waste is placed in windrows and processed into compost. The compost is sold to wholesalers in bulk and is available to residents from various retailers. In FY 2013, MES processed more than 46,823 tons of yard waste through this facility, resulting in the sale of 43,353 yards of Leafgro® leaf solid conditioner product.

MES began operating the 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®. In FY 2013, 574,850 bags of Leafgro®, a new record, and 64,241 yards of bulk Leafgro® were sold from this facility. During the year, MES and Montgomery County jointly



worked to achieve ISO 14001 (Environmental Compliance) certification for the Dickerson Compost Facility. In addition, Montgomery County and MES were honored with a SWANA GOLD Excellence Award for their Leafgro Marketing Program.

FOOD WASTE COMPOSTING

MES contracted with Sustainable Generation to provide for a test pilot demonstration of the Gore™ cover positive air composting system. This allowed for the addition of food waste to the yard waste available for composting. The system provides an accelerated processing time to generate compost, as well as elimination of any odors which may result from the addition of food waste. Prince George's County has indicated a desire to expand this process to the entire Western Branch site assuming a successful test demonstration is achieved.

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.



Garner scrap tire clean-up, before and after

In response to recent budgetary constraints, MES' emphasis has been placed on the cleanup of illegal scrap tire dumps which MDE has identified. All demonstration projects and school ground and athletic field enhancement projects were completed and the development of new projects has been temporarily suspended.

SCRAP TIRE DUMP CLEANUPS

Since the MDE/MES Scrap Tire Program began in 1994, MES has managed the cleanup of 27 sites, removing and properly disposing of approximately 3.5 million tires. In 2013, MES continued to monitor the stabilization and reforestation of the recently completed Garner/Brandywine Scrap Tire Clean-Up. This monitoring requirement will continue thru 2016 in accordance with the original project approval and permitting.

USED OIL PROGRAM

This program, administered by MES on behalf of the Maryland Department of the Environment, remains a popular recycling initiative for automotive and boating enthusiasts. MES provides contractual collection, hauling, maintenance and administrative services to support do-it-

yourself used oil collection centers. Currently, there are 140 collection locations statewide that accept used oil. MES also conducts audits of the existing collection locations to determine site viability and pollution prevention improvements recommended for each site. MES also continued with its routine inspections and cleaning of all 140 sites across the state. In FY 2013, MES contractors collected 555,201 gallons of used oil and 21,478 gallons of antifreeze.

BENEFICIAL USE OF LANDFILL GAS

MES continues with a long-term contract that allows C2i-Methane (formerly Blue Source) to operate a central flare station on the Midshore I site as well as provide gas well monitoring and system balance at no cost to the Midshore project. C2i-Methane's attempts at negotiating a power purchase contract with Easton Utilities have been unsuccessful to date as a result of the inability for Easton Utilities to agree upon an electric rate which provides C2i-Methane the ability to justify the installation of a landfill gas electric generation system. C2i-Methane continues to attempt to receive renewable energy credits for the landfill gas combusted via the central flare despite the current dramatic downturn in this market.



ECI Co-generation plant; flare at Midshore I

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 percent of the electrical and 100 percent of the thermal needs for this facility from the co-generation facility.

MIDSHORE REGIONAL II 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, the 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. MES continues to operate the regional homeowner drop-off site, located adjacent to Midshore II at Holly Road in Ridgely. In FY 2013, Midshore II accepted 101,000 tons of trash for disposal.

A major design project was initiated in FY 2013 involving the construction of the next landfill cell, Cell #2, at Midshore II. This project design will be completed in mid-FY 2014 and is planned to go to construction in late FY 2014. Anticipated cost of this project will be approximately \$4.5 million.

Midshore II Landfill received a GOLD Excellence Award for Landfill Maintenance in 2013 from SWANA, North America's largest solid waste association



Midshore II Landfill won the 2013 Solid Waste Association of North America's GOLD Award, their highest honor.

MIDSHORE I REGIONAL LANDFILL

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. In FY 2013, a total of 30,719 tons of solid waste was transferred to Midshore II from Midshore I.

In addition, design work commenced in FY 2013 for the final capping of Midshore I Landfill utilizing an innovative exposed geomembrane capping system. This design will significantly reduce the cost to cap the landfill as a result of eliminating the need to place thousands of yards of cover dirt onto the landfill. The total anticipated cost of this capping system will be approximately \$4 million and is planned to begin in late FY 2014. Once completed, this capping project will allow for the landfill to begin the

required 30-year monitoring period, as well as minimize the ongoing expenses related to maintaining the current Interim status of the landfill.

EXPANDED WORK ON THE EASTERN SHORE

MES work has expanded at other Eastern Shore landfill sites. 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.

In Dorchester County, MES completed the design of a Landfill Capping System for the County's Old Beulah Landfill. MES also continues to provide a Landfill Manager for the Dorchester County Beulah Landfill in Hurlock.



Midshore II Landfill in Ridgely, Maryland

FINANCIAL SECTION

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Report of Independent Public Accountants

To the Board of Directors
Maryland Environmental Service

Report on the Financial Statements

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

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

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



Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Service as of June 30, 2013 and 2012, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

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

Other Reporting Required by Government Auditing Standards

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

Hunt Valley, Maryland
September 30, 2013

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

Overview of Financial Statements

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

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

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

Net Position
(Expressed in Thousands)

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

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

Fiscal Year 2013

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

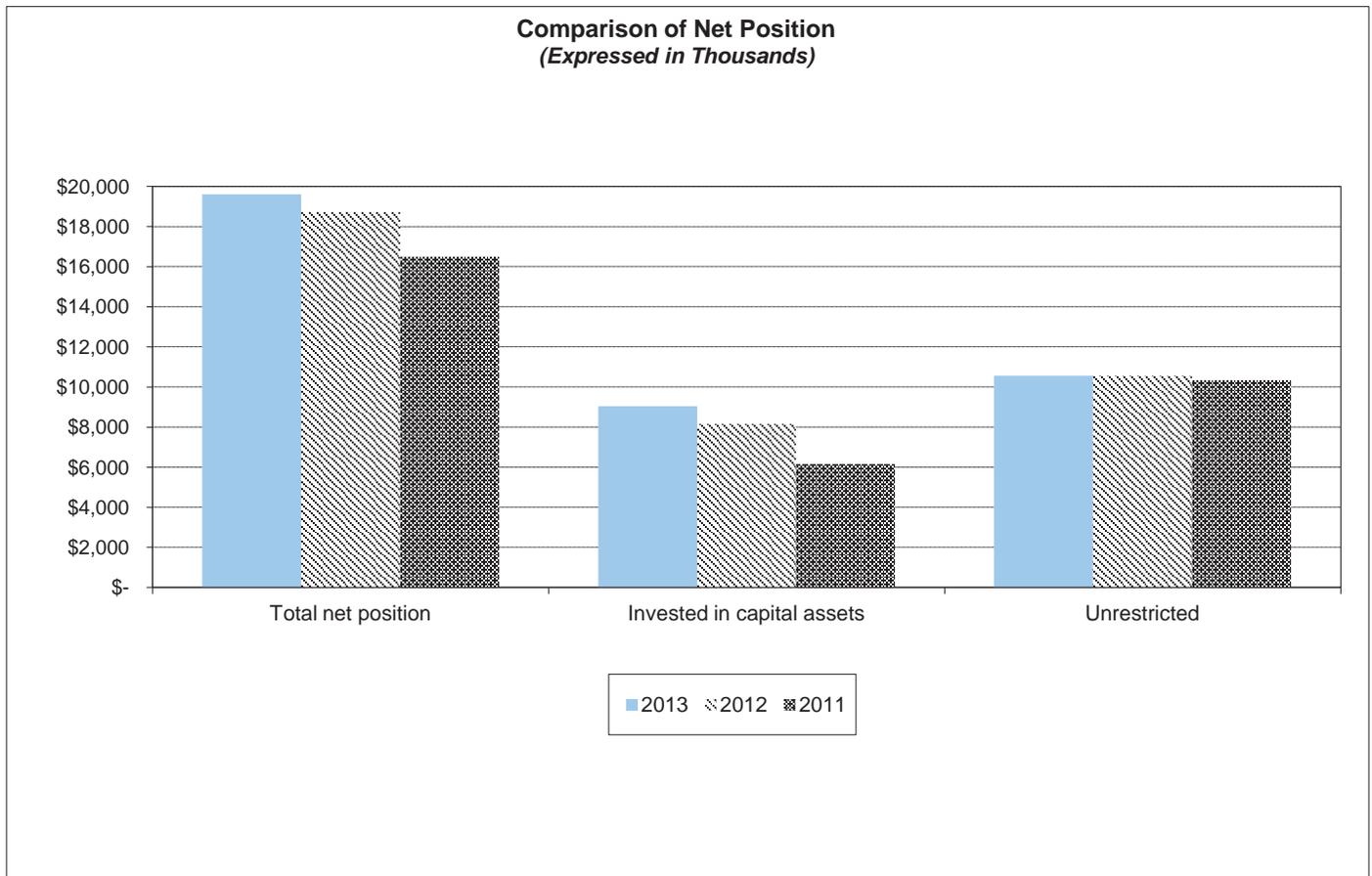
Total net position increased \$871 thousand in 2013 which is related to the excess of revenue over expenses. Invested in capital assets, net of related debt increased \$880 thousand from the payment of debt, net of depreciation. The remaining components, restricted and unrestricted net position of \$10,563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

Fiscal Year 2012

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

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

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



**Maryland Environmental Service
Management's Discussion and Analysis
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(In thousands except where noted)**

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

**Changes in Net Position
(Expressed in Thousands)**

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

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

**Revenue by Business Type Activity
(Expressed in Thousands)**

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

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

Revenue by Business Type Activity

Fiscal Year 2013

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

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

Fiscal Year 2012

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

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

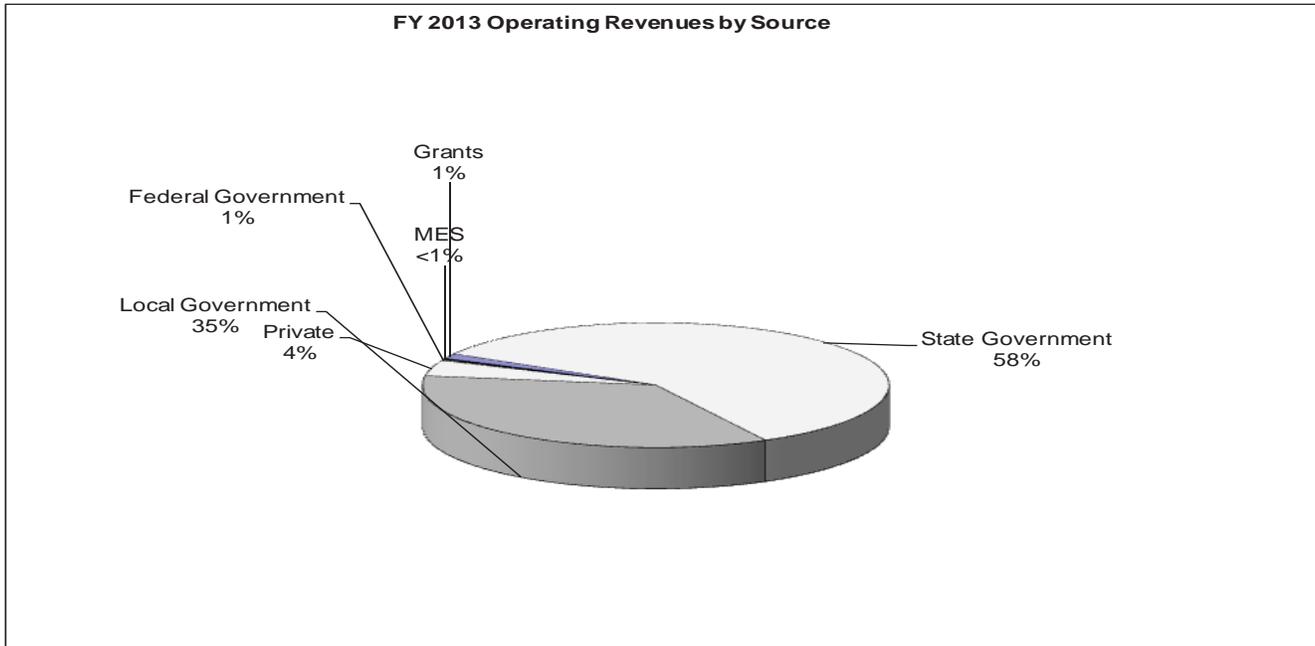
**Maryland Environmental Service
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(In thousands except where noted)**

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

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

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

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



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

Revenue by Source

Fiscal Year 2013

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

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

Fiscal Year 2012

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

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

Operating Expenses

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

Operating Income

Fiscal Year 2013

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

Fiscal Year 2012

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

**Maryland Environmental Service
Management's Discussion and Analysis
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(In thousands except where noted)**

Non-operating Revenue (Expense), Net

Fiscal Year 2013

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

Fiscal Year 2012

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

Grants

Fiscal Year 2013

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

Fiscal Year 2012

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

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

Investment in Capital Assets

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

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

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

**Capital Expenditures
(Expressed in Thousands)**

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

Fiscal Year 2013

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

Fiscal Year 2012

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

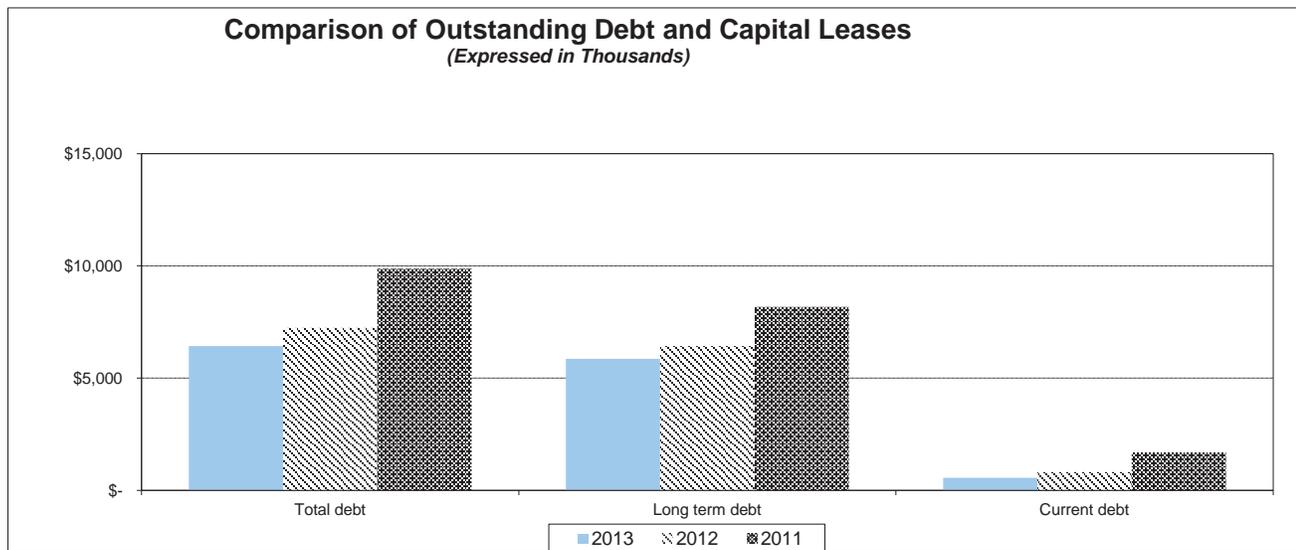
**Maryland Environmental Service
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(In thousands except where noted)**

Outstanding Debt

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

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

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



Fiscal Year 2013

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

Fiscal Year 2012

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

**MARYLAND ENVIRONMENTAL SERVICE
FINANCIAL STATEMENTS**

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

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

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

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

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

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

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

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

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

Midshore Regional Landfill Private Purpose Trust Fund

Statements of Net Position

As of June 30, 2013 and 2012

(Expressed in Thousands)

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

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

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

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

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

MARYLAND ENVIRONMENTAL SERVICE
Other Post Employment Benefit Plan
Statement of Plan Net Position
As of June 30, 2013
(Expressed in Thousands)

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

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

MARYLAND ENVIRONMENTAL SERVICE
Other Post Employment Benefit Plan
Statement of Changes in Plan Net Position
For the year ended June 30, 2013
(Expressed in Thousands)

Additions	
Employer contributions	\$ 288
Investment Income	
Net appreciation in fair value of investments	149
Interests and dividends	29
	178
Less investment expense	5
Net investment income	173
Total additions	461
Deductions	
Benefits paid	55
Net increase	406
Net position held in trust for other postemployment benefits	
Net position, beginning of year	1,295
Net position, end of year	\$ 1,701

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

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

(1) Organization and Summary of Significant Accounting Policies

(a) Reporting Entity

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

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

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

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

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

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

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

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

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

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

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

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

(c) Revenue Recognition

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

(d) Cash Equivalents

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

(e) Investments

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

(f) Direct Financing Leases

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

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

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

(g) Capital Assets

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

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

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

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

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

(h) Compensated absences

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

(i) Other Post-Employment Benefits (OPEB)

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(j) Advances from Project Participants

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

(k) Bond Discount

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

(l) Arbitrage

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

(m) Use of Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingencies at the date the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from these estimates.

(n) Recent Pronouncements

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

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

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

(n) Recent Pronouncements

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

(2) Cash and Cash Equivalents and Investments

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Maryland Environmental Service:

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

Midshore Regional Landfill:

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

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

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

OPEB Trust:

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

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

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

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

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

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

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

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

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

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

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

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

(4) Capital Assets (In Thousands)

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

Maryland Environmental Service:

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

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

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

Midshore Regional Landfill:

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

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

(5) Construction Commitments

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

(6) Concentrations of Credit

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

(7) Leases (In Thousands)

Operating Leases

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

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

Capital Leases

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

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

(7) Leases (In Thousands) (continued)

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

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

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

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

(8) Debt (In Thousands)

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

Maryland Environmental Service:

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

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

(8) Debt (In Thousands) (continued)

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

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

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

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

(8) Debt (In Thousands) (continued)

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

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

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

Midshore Regional Landfill:

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

\$1,752; interest at 1.1% paid semiannually in February and August; due in annual installments beginning 2013 through 2031 in varying amounts from \$90 to \$111.

	1,752
Total	19,325
Less: current portion	732
	\$ 18,593

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

(8) Debt (In Thousands) (continued)

Midshore Regional Landfill:

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

(In Thousands)

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

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

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

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

(8) Debt (In Thousands) (continued)

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

Maryland Environmental Service:

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

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

Midshore Regional Landfill :

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

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

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

(9) Unrestricted Net Position

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

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

(a) Business Research and Development/Contingency

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

(b) Equipment

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

(10) Accrued Workers' Compensation Costs

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

(11) Pension

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

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

(11) Pension (continued)

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

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

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

(12) Contingent Liabilities

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

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

(13) Landfill Closure and Postclosure Care Costs

State and Federal laws require the Service to cover and to perform certain maintenance and monitoring functions at Midshore I, Easton Landfill, Midshore II and Hobbs Road Landfill sites for 30 years after closure. Although closure and postclosure care costs will be paid near or after the date the landfills stop accepting waste, the Service reports 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, 2013. The landfill stopped accepting waste on December 31, 2010. Total closure and postclosure care costs for the landfill is currently estimated to be \$10,831 thousand, as determined through engineering studies and \$8,762 thousand and \$8,943 thousand has been recognized as a liability by the Service as of June 30, 2013 and 2012, respectively.

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

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

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

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

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

(14) Risk Management

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

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

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

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

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

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



**REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS ON INTERNAL
CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND
OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH *GOVERNMENT
AUDITING STANDARDS***

To the Board of Directors
Maryland Environmental Services

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the business type activities and fiduciary funds of the Maryland Environmental Service (the Service), a component unit of the State of Maryland, as of and for the years ended June 30, 2013 and 2012, and the related notes to the financial statements, which collectively comprise the Service's basic financial statements, and have issued our report thereon dated September 30, 2013.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Service's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Service's internal control. Accordingly, we do not express an opinion on the effectiveness of the Service's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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



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Compliance and Other Matters

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

Purpose of this Report

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

Hunt Valley, Maryland
September 30, 2013

SB & Company, LLC



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