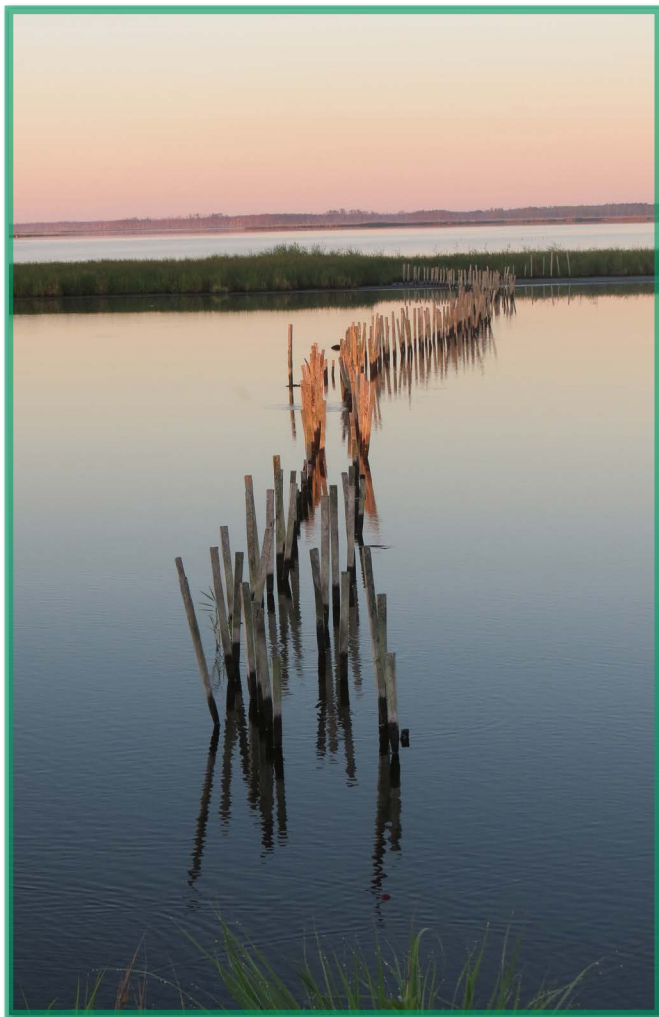


ANNUAL REPORT 2016

MARYLAND ENVIRONMENTAL SERVICE ANNUAL REPORT 2016

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BOARD OF DIRECTORS

John J. O'Neill, Jr., Deputy Director

Richard P. Streett, Jr., V.M.D., Secretary

Janet R. Irvin, Treasurer and Chief Financial Officer

William B. C. Addison, Jr.

Kevin Hedge

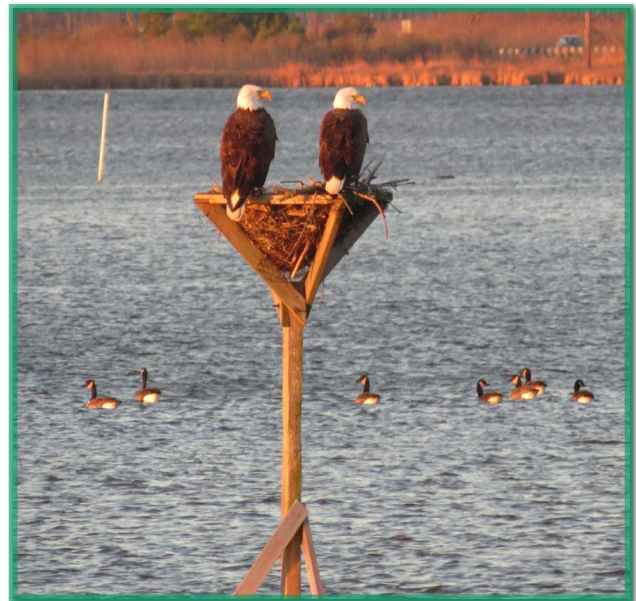
Leslie Jackson Jenkins, Esq., CPM

J.P. Smith, Jr.

Joseph F. Snee, Jr., Esq.

James M. Harkins, Director

(Served until March 31, 2016)



*Photos on these pages by
Beverly Addison*

WHO WE ARE

In 1970, Maryland's Governor and legislators created Maryland Environmental Service to provide "dependable, effective and efficient" water supply and waste purification and disposal services in compliance with State laws, regulation and policies governing air, land and water pollution to public and private instrumentalities. The Maryland Environmental Service (MES) is an independent State agency that functions as a fee-for-service public corporation. MES provides technical services to clients for planning, engineering, design, financing, construction and project management, monitoring, inspection and operation of environmental facilities. These technical services support water supply, wastewater treatment, energy supply and solid waste management to State agencies, federal agencies, counties, municipalities and private entities. MES serves as the environmental utility arm for State government.

The MES Act (MD Code, Natural Resources Title 3, subtitle 1) was adopted in 1970, giving MES the authorization to carry out certain responsibilities relating to the environment. Executive Order 01.01.1971.11, directing MES to assume responsibility for State owned facilities was adopted in 1971, and the Policy Statement Concerning State-Owned Water, Wastewater and Solid Waste Management Facilities was approved by the Board of Public Works (BPW) on January 3, 1979. These documents help define the relationship with clients such as State agencies that budget for MES services in their operating budget. MES also enters into agreements with a number of State agencies, federal agencies, local governments, and the private sector. MES's overall operations are organized into four main groups: Water/Wastewater, Environmental Operations, Technical and Environmental Services and Administration.

As a non-appropriated, non-profit agency, MES performs work that it is hired to do. It does not independently initiate work because it has no funding to do so. MES follows a business model that enables it to recover project costs from its clients. All direct expenses incurred by MES, such as employees' hourly labor rates, are charged to the client so those costs are recovered. Indirect overhead expenses, such as fringe benefits and general administrative costs, are calculated annually as a percentage of labor performed. This overhead percentage is applied to the total labor charges, so MES is able to recover costs that cannot be directly identified to a project, such as health insurance and rent. Other expenses, such as contractual services and technical fees for work performed by the private sector are included in the client invoice.



Water Sampling

MES does not mandate what clients can and cannot do, but rather works with its clients to help them efficiently and affordably resolve environmental challenges with special emphasis on environmental compliance and safe work practices. Over the last fiscal year, MES managed 886 diverse projects, ranging in cost from \$500 to \$13 million. Services include water and wastewater treatment, solid waste management, composting, recycling, dredged material management, hazardous materials cleanup, storm water services and renewable energy.

Often times MES acts as a catalyst between the public and private sector to make projects happen. Of the Agency's total annual operations of \$160 million in FY 16, more than \$105 million was passed through to private sector firms.

Today, Maryland Environmental Service remains focused on finding innovative solutions to our region's most complex environmental challenges and providing top-notch customer service, while protecting Maryland's air, land and water resources.

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.*



Hart-Miller Island

LETTER FROM THE DEPUTY DIRECTOR

It is a pleasure to introduce the Maryland Environmental Service's Annual Report for Fiscal Year 2016. The Service has continued to provide cost effective, environmentally-sound affordable solutions to our many customers, both at the State and local level, as well as a small number of private users. Our 850 employees staff projects statewide and are available on a 24/7 basis to respond to our customers' needs. Highlights of our efforts this year include the following programs.

On one month's notice we assumed responsibility for operating the Recycling Facility in Prince George's County. The County requested MES assistance after the contract with a private vendor terminated and the County did not receive any bids for a successor. Our staff had to quickly rehabilitate the plant and its equipment so that services in this critical sector could continue. The County expressed appreciation for the hard work of our employees and has continued the contract. In Harford County, we have continued to operate the County's Solid Waste program for a second year and likewise the County has expressed satisfaction with the dedicated work by MES employees to deliver a quality operation at a very efficient price.

The Water/Wastewater Group has continued to streamline the delivery of capital projects at State facilities. Challenges this year have been sharply rising costs for these important facilities and limited State funding. The Service has employed reallocation of resources, rescheduling of work and rebidding of some components to keep costs manageable. Major installations at Rocky Gap, Maryland Correctional Institution (Hagerstown), Freedom District (Sykesville), Charlotte Hall Veteran's Home, Southern Maryland Pre Release Unit and Cheltenham Youth Center have been underway or completed. Several more projects at Eastern Correctional Institution Wastewater and Power Plant have also been under design for bidding next year.

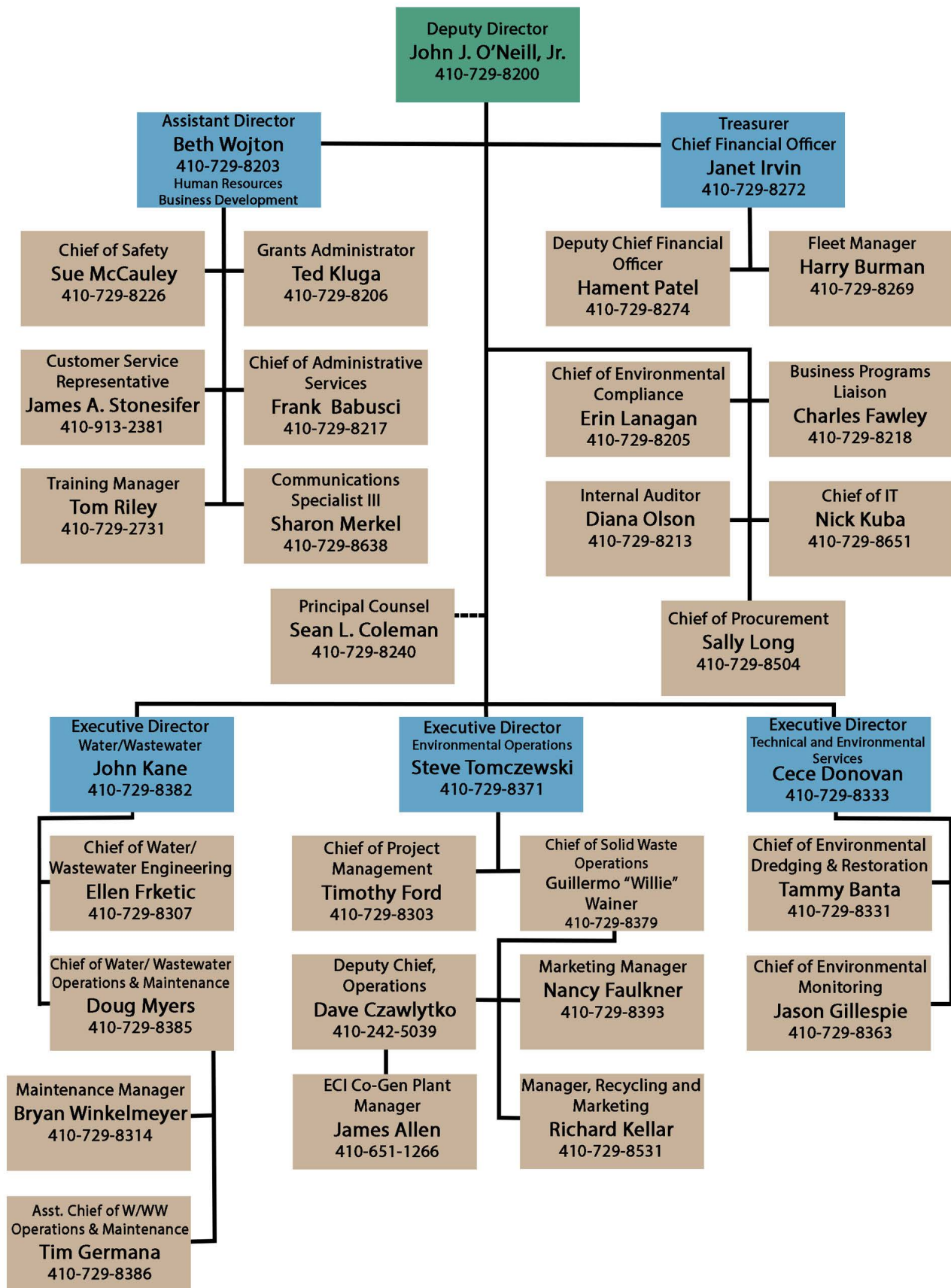
Major projects have also been underway for the Maryland Department of Transportation Port Administration to keep Baltimore's Harbor one of the top ports in the country for international shipping. The Service assists the Port Administration with dredge material handling to produce attractive, environmentally friendly habitat for wild life while rebuilding areas that have eroded. Our staff also assists in cleaning up industrial sites to return them to healthy areas for reuse as port facilities or for recreation.

Our staff is extremely committed to protecting and enhancing Maryland's environment, and they strive every day to improve the State's land and water resources. I think you will enjoy reading about our many projects.



A handwritten signature in black ink, reading 'John J. O'Neill, Jr.'.

John J. O'Neill, Jr.
Deputy Director



TECHNICAL AND ENVIRONMENTAL SERVICES

The Technical and Environmental Services Group supports State, County and Local Government agencies with services related to environmental monitoring and environmental dredging and restoration.

The Environmental Monitoring Division provides comprehensive water quality, environmental management, renewable energy, field operations and maintenance and geospatial and engineering services to benefit the citizens of Maryland.

Through strategic partnerships across the public and private sector, the Environmental Monitoring Division currently helps State and Local Government clients find cost-effective means of meeting their environmental mission.

The Environmental Dredging & Restoration Division (EDRD) supports the Maryland Department of Transportation Port Administration's (MPA) mission by providing dredged material management services including planning, permitting, monitoring, reporting, operating and maintaining dredged material containment facilities (DMCF), with an emphasis on environmental restoration and the innovative reuse of dredged material. MES operates a public outreach program related to these projects as well. In addition, MES provides hazardous material and site management support, environmental management system service and environmental compliance services to various clients.

The efficiency of MES procurement practices allowed significant levels of project funding to flow to the private sector using MES competitive procurement policies in FY 16. Firms who benefited from these project procurements included contractors, consultants, utility suppliers, equipment vendors, material and supply firms, permit expeditors, reviewers and others.



Wetland Delineation

What our customers have to say about Technical and Environmental Services...

"On behalf of everyone, we thank you for the great job. I received outstanding feedback on your work and we believe that the County, overall, is in a better place as a result of this work."

Radu Zamfirache, Baltimore County

"MES has been a valuable resource in helping us implement our unique mission. Whether developing a web-based deep mine mapping tool or organizing decades of water quality data into a GIS system, MES always seems to have the expertise and experience we need."

Mike Garner, MDE

"The written materials, advice, questions you asked, details you nailed down and coordination you did among the team, and, in some cases with representatives of other agencies, were nothing short of stellar as evidenced by how smoothly the meeting went today. It is a privilege to work with each of you and to see the synergy among team members. Thank you for working to ensure that we deliver accurate information to the public in a highly professional manner."

Chris Correale, Director of Harbor Development, MPA

Technical and Environmental Services in 2016

In 2016, MES began work with the Resiliency Partnership to analyze floodplain risk in a collaborative way to reduce costs. This allowed the State to focus additional resources on outreach to citizens and local jurisdictions of Maryland with a goal of minimizing potential flooding impacts to homeowners and businesses.

Also this year, MES was requested to perform a Poultry Litter Request For Information (RFI) to gather information to help State agencies develop solutions for application of nutrients to farmland from poultry litter. The RFI was issued in FY 2016 and received 24 responses. MES worked with other agencies to compile and summarize the responses, and prepared a report and recommendations for use by policy makers.

The Poplar Island Expansion agreement between MPA and the Corps of Engineers Baltimore District was also finalized in 2016 and initiation of construction of the expansion is occurring. This will provide dredged material placement capacity and more acres of wetland and upland island habitat in the Chesapeake Bay, constructed from clean dredged material. MES will provide continued operations and support for construction staging to MPA and the Corps. MES and consultants also completed the feasibility study for the expansion of the Cox Creek DMCF. Demolition work commenced on dozens of vacant, crumbling buildings on the property in 2016. A local Maryland company received the competitive bid award from MES to perform this demolition.

MES has been supporting documentation and tracking of the Department of Housing and Community Development's (DHCD) Customer Investment Fund Targeted & Enhanced Weatherization Program (CIF). This program expanded during FY16 with MES providing post weatherization and energy education support services to low income residents in Baltimore via LEED-certified (Leadership in Energy and Environmental Design) specialists.



MES Surveying Staff



Outreach at Masonville Cove

Vendor Relationships

TES works hard to establish beneficial relationships with qualified vendors to provide service to State and Local Governments. We keep our qualified vendors informed, and work with them as part of a team, but we also hold them accountable to provide the services our clients need. We stay focused on fiscal responsibility through use of vendors in a cost effective way. We perform outreach to the business community, so they are aware of upcoming work, and we stress participation of small businesses and minority businesses in the work MES contracts. TES organized an outreach event with the American Council of Engineering Companies in 2016 to familiarize local engineering firms with MES and upcoming work.

MES is currently maintaining 12 competed short lists of qualified firms, representing over 35 prime firms as well as over 60 support firms to enable quick service to clients from teams including qualified private sector firms.



Snow Removal at BWI

MES is proud of our relationship with our vendors.

Smith Planning & Design, LLC

"...collaboration was made possible through the efforts of MES to assemble and maintain the team of qualified professionals from both the public and private sector. Our firm has greatly benefited and has enjoyed being a part of a team...."

Michael Baker International

"We have had the opportunity to provide assistance to many Maryland localities and State agencies through MES to provide cost-effective and high quality support. MES is instrumental within the State of Maryland to get projects done and done right to support the needs of countless government agencies."

AMEC Foster Wheeler

"As a current MES contractor, we truly view our relationship with MES as a mutually beneficial partnership that continues to produce positive results for state and local clients. We look forward to continuing this successful relationship in the future."



Staff Installing a Lift-Station Pump at BWI

WATER AND WASTEWATER SERVICES



Maryland Correctional Institution WWTP



Maryland Correctional Institution WWTP



Glenelg WWTP

The MES Water and Wastewater Services group operates and maintains municipal, County and privately owned facilities, as well as State-owned plants at correctional facilities, health facilities, rest areas and State parks. MES also provides services in some areas that do not have access to public water and sewer. We use our resources to work to insure that both large and small-scale treatment systems meet the current treatment and regulatory requirements and that the plants are staffed by qualified licensed operators.

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 and an expert water tank team who can provide complete tank services.

Our engineering staff manages design and construction of capital improvement projects and other public works projects. We help our clients determine their water and wastewater needs, assist in selecting the right size facility and the right technology and equipment, prepare specifications and oversee the construction of new plants.

The biosolids group works to ensure that environmentally acceptable, reliable, and cost effective use of the solid material generated by the Agency's numerous wastewater treatment plants is practiced.

With years of experience in the operation of all of 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.

Water and Wastewater Services in 2016

Maryland Environmental Service has had responsibility for planning and implementing capital improvement projects at State facilities since FY 1992. This includes projects such as upgrades to wastewater treatment plants (WWTP) for nutrient removal, new water plants, sewer collection system replacement, and water distribution system repairs. In FY 2016, MES was authorized \$16,471,000 by the Maryland General Assembly for 15 projects. This is the largest appropriation given to MES in a single year for the greatest number of projects.

In FY 2016, MES began or continued work efforts on 13 projects and had 2 major facilities ready to bid by the end of the fiscal year. These 2 projects, Eastern Correctional Institution WWTP expansion and upgrade and Rocky Gap State Park WWTP upgrade, are scheduled to have construction contracts awarded in FY 2017.

Also this year, MES Engineering staff managed upgrades to wastewater treatment plants in two southern Maryland locations, Charlotte Hall Veteran's Home and the Southern Maryland Pre-Release Unit. Ongoing upgrades also continue at the Freedom District WWTP and Maryland Correctional Institution at Hagerstown WWTP. These upgrades will add enhanced nutrient removal capability.

In addition, MES developed a proposal for Anne Arundel County Public Schools for six schools that needed assistance with their water treatment. MES employees now make weekly visits to the sites and report any deficiencies to the AACPS Supervisor of Operations. With all identified issues immediately addressed by the AACPS, the program successfully stops potential problems before they become water quality issues.

What our customers have to say about Water and Wastewater...

"I find MES personnel to be very responsive. Any problems are always dealt with in a timely manner. We have a very good working relationship with MES."

Derek K. Thornton, Assistant V.P., Campus Operations, St. Mary's College of Maryland

"We are very pleased with our relationship with MES. Whenever I have questions or requests MES responds very quickly."

Christopher E. Williams, MHS, CIH, Environmental Issues Program Manager, Office of Operations, AACPS

"We were given a one month notice to find another operator...Shamrock management had to quickly interview several different organizations/businesses to find a qualified company with the knowledge and business ethics we desired...Since then there has been no question about our hiring MES. We have been extremely satisfied with their performance and oversight of the operation. There has not been one day when we have thought of changing to another operator. This is a rare attribute in today's business world."

Donna Demmon, General Manager Fitzgerald's Shamrock Restaurant



Construction at the Southern Pre-Release Unit WWTP

Water/Wastewater Engineering staff has been assisting our clients to meet the new 12-SW permit requirements by preparing storm water pollution prevention plans using the more stringent guidelines. These plans include calculating the impervious surface reduction required and presenting options to the clients on how to best meet the requirements with minimal impact to their business and costs.

MES continued to provide services to St. Mary's County in 2016 with the inspection of 313 stormwater structures. The County is divided into 3 regions, and each region is inspected once every 3 years as mandated by MDE. The structures are inspected for signs of erosion, functionality, excessive vegetation, condition of the components and overall condition of the stormwater structure.



Installation at Charlotte Hall WWTP

MES' Biosolids Management Group is involved in a third-party, independent land application compliance inspection program conducted on behalf of the DC Water's Blue Plains Advanced Wastewater Treatment Plant and several of the Washington Suburban Sanitary Commission's wastewater treatment plants. Our trained inspection staff ensures compliance with State and Federal regulations every day at each site where the material is being applied. This inspection program emphasizes daily compliance inspections, recordkeeping/database management and public outreach tasks.



Biosolids at Freedom WWTP

What our vendors have to say about MES...

WATEK Engineering Corporation

"WATEK has been involved in over 20 MES projects in the last 21 years. It has been a pleasure working with the dedicated and hard-working MES staff, both from Engineering, as well as the Operations side. Their care for the safety, health and financial interest of the public is evident in all project decision making processes. We are also impressed by the MES staff's reliance and use of advanced technologies in their recent projects with sustainable and green approaches."

George, Miles and Buhr, LLC

"The success of our projects is due in large part to the collaborative efforts of MES' experienced and highly skilled engineering, project management and facilities operations team."

MES' Operators

MES has a team of highly trained water/wastewater operators who have been participating in Regional and National Operations Challenges. The Challenge, sponsored by the Water Environment Federation and local Member Associations, is designed to test the skills required for the operation and maintenance of wastewater treatment facilities.

The MES team was formed in 2013 and has won first place at the local member association level every year. This has allowed them to represent the region at WEFTEC, the annual conference of the Water Environment Federation, where they have competed against nearly 40 teams from the US and abroad.

MES offers a three-year apprenticeship program for those interested in a career as a water/wastewater operator. Upon successful completion of the program, operators become fully certified water/wastewater operators in the State of Maryland. In 2016, we graduated four employees from the Operator-In-Training Program.



Jim Elliott, Wayne Rumbaugh, Kirk Parks, and Brad Yeakle

Motley Poo Wins

1st place, Safety, Lab and Collection events,
Division 2, NJWEA conference, 2015

1st place, overall winner, Division 2,
NJWEA Conference, 2015

1st place, Collection and Process Control events,
Tri-Association Conference, 2015

1st place, Collection and Safety events, Division 2,
WEFTEC 2015

1st place overall winner, Division 2, WEFTEC 2015



Brad Yeakle

Wayne Rumbaugh



ENVIRONMENTAL OPERATIONS

The Environmental Operations Group (EO) strives to provide superior customer service and to satisfy our clients in the most cost effective and environmentally responsible manner. We provide services such as solid waste landfill operations management, single and dual stream recycling facility operations and marketing, homeowner drop off operations and waste transfer operations. We also handle yard and food waste composting and marketing, co-generation and steam power facilities management, mobile yard waste grinding services, leachate and solid waste transportation, used motor oil and CFC collection services and scrap tire collection and site remediation.

The Engineering Section provides planning, site evaluation, permitting, design, inspection, quality assurance and construction management services on all types of municipal solid waste management projects, including landfills, transfer stations, recycling systems, waste to energy, and landfill gas management. In the last 5 years this group has administered over \$50,000,000 in construction and services contracts. By providing detailed environmental monitoring assessments that quickly identify and refine the most cost effective solutions, we are proud to have saved our clients significant amounts of money in remediation costs by tailoring the correct environmental solution to address the problem.

This section is also responsible for the routine monitoring and reporting at 21 landfills sites in Maryland. We provide services for environmental delineation and remediation to clean up groundwater, landfill gas and surface water contamination at our client sites. Landfill gas remediation systems are used to remove migrating contaminants in the ground or to ensure that sites are in compliance for greenhouse gas emissions. Finally, the monitoring group is responsible for writing stormwater pollution and prevention plans (SWPPPs) and spill countermeasure and control plans (SPCCs) for clients' sites.



Employee Measuring Temperature of Compost at Western Branch



Recycling Truck in Queen Anne's County

Environmental Operations in 2016

Prince George's County decided not to renew its operating contract for the Prince George's Material Recovery Facility located in Capital Heights. The County issued an emergency RFP, but no viable responses were received, leaving them in a crisis with no operator for processing the County single stream recycling material. The County turned to MES. At the request of Prince George's County, MES started the operation of the county owned Material Recycling Facility (MRF) on November 1, 2015.

The Prince George's County MRF is a single stream facility that processes over 63,000 tons of commingled material per year. Initially, MES spent a month repairing the existing equipment and conducting various building and equipment improvements to bring the facility to safety compliance and operational viability. Since the equipment rehabilitation, MES has been gradually increasing production and profitability to the County. Currently, the plant is processing an average of 240 tons of single stream per day, compared to approximately 170 tons per day during the first few months of operation. MES has contracted out with a local MBE vendor, CMT Services Inc., to provide recycling sorters and general labor services. The annual contract amount with CMT Services is approximately \$1.6 million.

Similarly, at the request of Harford County, MES assumed responsibility for the Harford County Solid Waste program on September 1, 2015. Our responsibilities include: landfill operations, homeowner drop off operation, roadway litter collection, yard waste composting and noxious weed control. Our operation significantly reduced the cost of providing solid waste services to Harford County. Also, ongoing citizen complaints to MDE were significantly reduced due to a strong customer service initiative.



Prince George's County Materials Recycling Facility

What our customers have to say about Environmental Operations...

"Through our partnership with Maryland Environmental Service, I am pleased that we are in a position to offer extended service hours for Harford County residents."

Barry Glassman, Harford County Executive

"MES has been an outstanding partner for Caroline County and the Midshore region for many years. MES regional solid waste and recycling programs are a model for the entire state. MES' work with Caroline County is an outstanding public-private partnership that delivers value to stakeholders. The work MES has done in the Midshore is exactly why MES was created in the first place."

Ken Decker, Caroline County Administrator

"It's about \$550,000 less than when we were doing it ourselves, if you average in the two extra months. That's the beauty of working with them. We only pay them for what they're doing."

Billy Boniface, Harford County Director of Administration

FY 16 was also a busy year for the Engineering and Monitoring Group. The group installed three landfill capping systems, including an innovative exposed geomembrane cap system at our Midshore I landfill, Old Beulah Landfill and the old landfill cells at Harford County (HWDC). We also completed construction of a new landfill cell in Harford County. In addition, we opened a new solid waste transfer station in Baltimore County at the Eastern Landfill and began additional paper/cardboard separation for Montgomery County.

MES also initiated upgrades to the electrical control system for the Eastern Correctional Institution's Wood Fired Combined Heat and Power System.

The Monitoring group has begun work on a study to address the source of groundwater contamination at the Nicholson Landfill in Kent County. The site work includes the repair of broken landfill gas vents, the re-configuration of a landfill gas contaminated pump and treat system and the installation of seven landfill gas probes and one monitoring well.

MES is proud to partner with local, small and minority owned businesses.

Annette Johnson, CMT Services Inc.

"Having the opportunity to have a contract with MES has done a phenomenal job in assisting CMT Services in workforce development. We are able to employ and give people opportunities that will provide sustainability to their life and that has been the most rewarding part of doing business with MES. It gives others opportunities."

Rafael Navarro, Colossal Contractors, Inc.

"Definitely we love to partner with MES, because it makes our business grow. The diversity of work that they have to help the environment is good for all of us and it has made us do different kinds of work that we were not doing before. It's excellent and has helped us grow our business".



Employees at the Montgomery County Grinding Operations



Construction of a New Landfill Cell

Tire Cleanup

In 2016 MES was tasked by the Maryland Department of the Environment with cleaning up a long abandoned tire dump in Anne Arundel County called the Boehm Site. The Boehm Site is Maryland's largest known tire dump, dating back to the 1950's. The site contained hundreds of thousands of tires.

The \$2.5 million cleanup will be the latest in a two-decades-old effort by MES and the Maryland Department of the Environment that has resulted in the removal of 10.6 million tires from more than 900 sites around the state.

Additionally, MES in collaboration with the Maryland Department of the Environment, and the Maryland Farm Bureau, coordinated the second consecutive state-wide Agricultural Scrap Tire Collection Event. The program included 17 Maryland counties. In addition, the Anne Arundel County Economic Development Corporation and three sites sponsored by Farm Bureau members in Montgomery, Baltimore and Frederick Counties participated. Collectively, the 21 locations collected and disposed of more than 3,415 tons of scrap tires. This event combined with 10 other citizen and agricultural tire collection events since 1998 have resulted in the diversion and recycling of 18,579.2 tons of tires. This is the equivalent of 1,857,920 passenger car tires.

Finally, MES began the design process aimed at cleaning up another decades old scrap tire dump in Howard County called the Tyler Towing/Clarksville Site. This property was used as a junkyard for decades in Howard County. There are estimated to be 61,376 scrap tires in stockpiles throughout the property. MES will begin cleaning up the tires in FY17.



Post Cleanup at the Boehm Site



Part of the Boehm Site Before Cleanup



Some of the Removed Tires

Masonville Floating Wetlands





259 Najoles Road
Millersville, MD 21108

(A Component Unit of the State of Maryland)

Financial Statements

Fiscal Year Ended June 30, 2016 and 2015

(With Independent Public Accountants' Report Thereon)



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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 statement of net position of the Maryland Environmental Service (the Service), a component unit of the State of Maryland, as of June 30, 2016 and 2015, and the related statements of revenue, expenses and changes in net position and cash flows for the years then ended, and the related notes to the financial statements, which collectively comprise the basic financial statements.

Management's Responsibility for the Financial Statements

The 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 opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits 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.



SB & COMPANY, LLC
KNOWLEDGE • QUALITY • CLIENT SERVICE

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, 2016 and 2015, and its changes in 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's discussion and analysis and required supplemental information for other postemployment benefit plan and required schedule of proportionate share of net pension liability 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 29, 2016, 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 29, 2016

Maryland Environmental Service
Management's Discussion and Analysis
June 30, 2016 and 2015
(In thousands except where noted)

Overview of Financial Statements

Maryland Environmental Service (the 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 present a 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 year ended June 30, 2016 with 2015 for comparative purposes. 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, 2016 and 2015:

Net Position <i>(Expressed in Thousands)</i>		
	2016	2015
Current and other assets	\$ 62,428	\$ 85,872
Capital assets	18,641	18,539
Total assets	81,069	104,411
Deferred outflows related to pensions	767	331
Current and long-term debt and capital leases	4,657	5,278
Other liabilities	53,133	77,217
Total liabilities	57,790	82,495
Deferred inflows related to pensions	221	230
Net position:		
Net investment in capital assets	13,985	13,261
Restricted	12	12
Unrestricted	9,828	8,744
Total net position	\$ 23,825	\$ 22,017

**Maryland Environmental Service
Management's Discussion and Analysis
June 30, 2016 and 2015
(In thousands except where noted)**

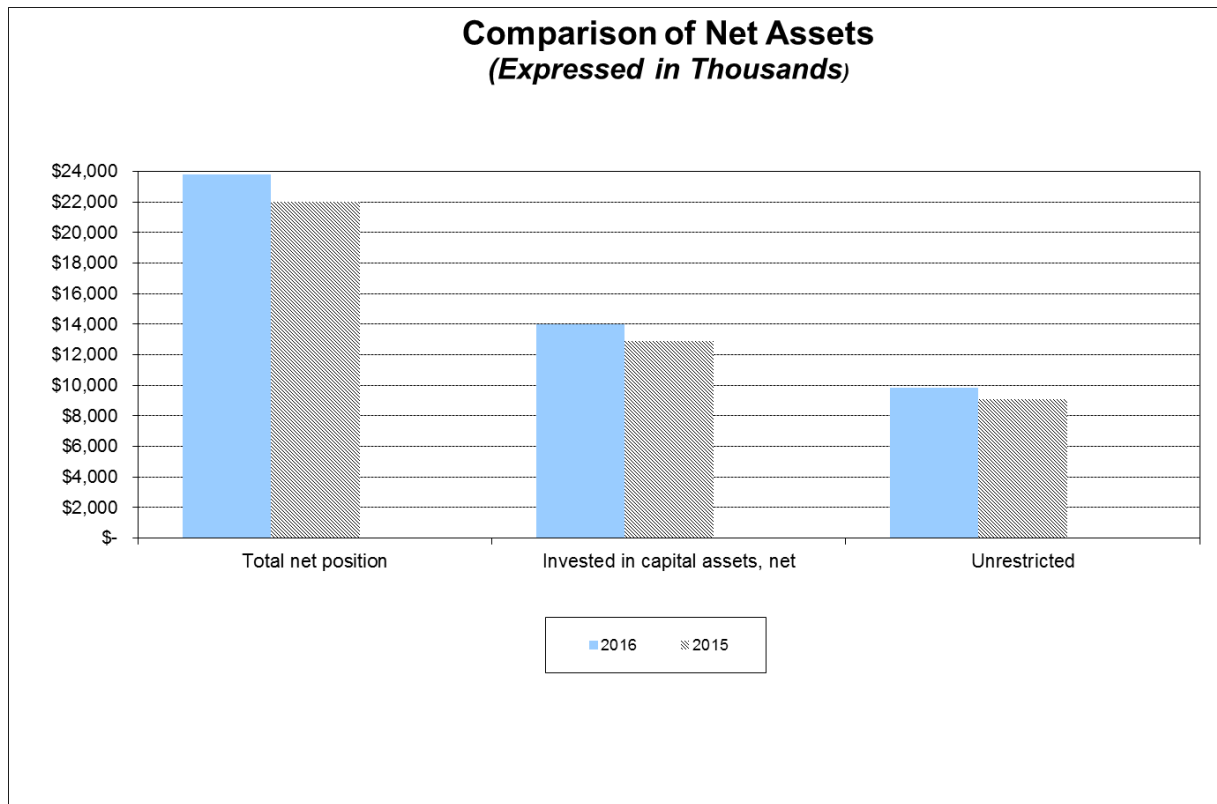
Fiscal Year 2016

Net position represents the difference between total assets and deferred outflows and total liabilities and deferred inflows.

The Service implemented GASB No. 68, Accounting for pensions. This had a zero impact on the net position as the Service recorded a due from project participants as the pension costs will be recovered from the participants.

Total net position increased \$1,808 thousand in 2016 which is related to the excess of revenue over expenses. Net investment in capital assets increased \$724 thousand from the addition to equipment, and payment of debt. The remaining components, restricted and unrestricted net position of \$9,840 thousand, represent funds available for future expenditures. Over time, increases and decreases in net position provide an indicator of improving or deteriorating financial position.

A comparison of years ended June 30, 2016 and 2015 are presented graphically below:



Maryland Environmental Service
Management's Discussion and Analysis
June 30, 2016 and 2015
(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, 2016 and 2015:

Changes in Net Position <i>(Expressed in Thousands)</i>		
	2016	2015
Total operating revenue	\$ 159,505	\$ 141,173
Operating expenses		
Salaries and benefits	50,090	44,340
Other	93,046	81,249
General and administrative	14,311	13,746
Total operating expenses	157,447	139,335
Operating income	2,058	1,838
Nonoperating expense, net	(250)	(388)
Change in net position	1,808	1,450
Net position, beginning of year	22,017	20,567
Net position, end of year	\$ 23,825	\$ 22,017

The following table presents revenue by business type activity for the years ended June 30, 2016 and 2015:

Revenue by Business Type Activity <i>(Expressed in Thousands)</i>		
	2016	2015
Environmental dredging & restoration	\$ 41,666	\$ 53,325
Water/wastewater operations	33,809	24,196
Recycling	16,001	14,295
Solid waste management	34,738	16,289
Energy co-generation	6,769	7,891
Environmental engineering	2,735	1,908
Environmental monitoring	16,499	14,596
Hazardous waste treatment	4,819	5,500
Grants	2,061	2,663
Other	408	510
Total revenue	\$ 159,505	\$ 141,173

**Maryland Environmental Service
Management's Discussion and Analysis
June 30, 2016 and 2015
(In thousands except where noted)**

Revenue by Business Type Activity Fiscal Year 2016

The total increase in operating revenue for the year ended June 30, 2016 was \$18,332 thousand over June 30, 2015. The change represents an increase of 13% in operating revenue. There were increases in Solid Waste of \$18,449 thousand, Water/Wastewater plant construction of \$9,613 thousand, Environmental Monitoring of \$1,903 thousand, and Recycling of \$1,706 thousand.

The large increase for Solid Waste is attributable to four new projects that came online during FY 2016: Harford County Solid Waste, Baltimore County Solid Waste - Eastern Acceptance, Prince George's County Materials Recycling Facility and also the operation of MCI-Hagerstown steam plant. The Water/Wastewater construction project revenue changes included the continuation of upgrades to the Freedom District plant and other smaller plants throughout the state. Environmental Monitoring's increase was due to continued efforts on various mapping efforts and permitting database development for Maryland Department of the Environment and storm water work with Corvias Solutions for Prince George's County. The increase to Recycling revenue is from increased activity on scrap tire collection and disposal and Montgomery County yard waste activity.

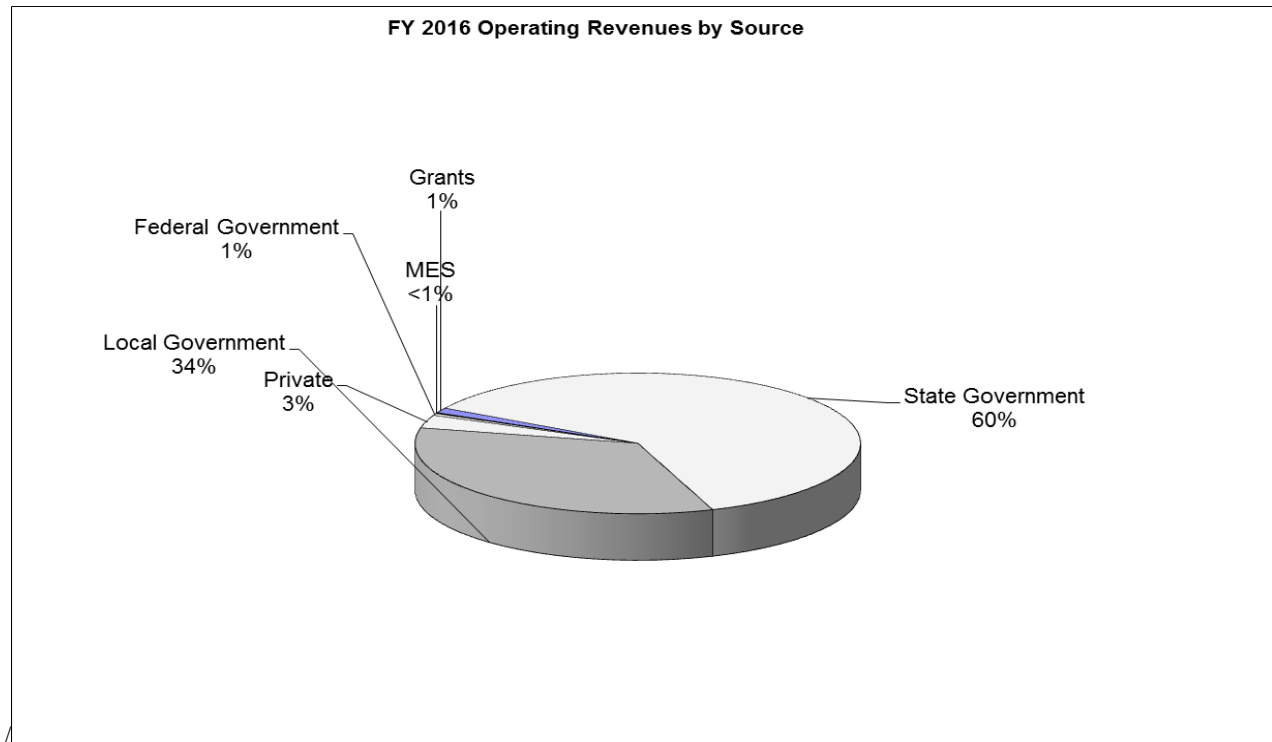
The following table presents revenue by source for the years ended June 30, 2016 and 2015:

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

	2016	2015
State government	\$ 97,246	\$ 95,014
Local government	54,416	38,389
Private	4,745	4,636
Federal government	704	129
MES product revenues	333	342
Grants	2,061	2,663
Total revenue	\$ 159,505	\$ 141,173

**Maryland Environmental Service
Management's Discussion and Analysis
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The following graph presents revenue by source for the year ended June 30, 2016:



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

Fiscal Year 2016

State government revenues increased by \$2,232 thousand in 2016, while local government revenue increased by \$16,027 thousand. Grants decreased by \$602 thousand, and all other sources of revenue increased by \$675 thousand.

The operations of the MCI-Hagerstown steam plant and the Freedom District plant upgrade were the two large projects that contributed to the State revenue increases. The local government revenue increase was related to new projects: Harford County Solid Waste, Baltimore County Solid Waste - Eastern Acceptance, and the Prince George's County Materials Recycling Facility. The grant decrease was flood plain mapping for Maryland Department of the Environment.

Fiscal Year 2015

State government revenues increased by \$27,543 thousand in 2015, while local government revenue increased by \$1,265 thousand. All other sources of revenue increased by \$2,048 thousand.

The Oyster Restoration Project and the Masonville Dredged Material Containment Facility construction project continued to be the two large projects that contributed to the State revenue increases. The local government revenue increase was related to the Montgomery County Yard Waste project and the operation of the Baltimore County Single Stream Recycling facility.

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% of revenue in 2016 and 99% in 2015.

Operating Income Fiscal Year 2016

Operating income reported in 2016 was \$2,058 thousand compared to \$1,838 thousand in 2015, an increase of \$220 thousand. An increase in indirect cost recovery as a result of the growth in labor revenue in Solid Waste.

Operating Income Fiscal Year 2015

Operating income reported in 2015 was \$1,838 thousand compared to \$1,361 thousand in 2014, an increase of \$477 thousand. The reasons for the increase in operating income from the previous fiscal year were an increase in indirect cost recovery as a result of the growth in labor revenue and an increase in the project variances, particularly the GIS services and Tub Grinding services.

**Maryland Environmental Service
Management's Discussion and Analysis
June 30, 2016 and 2015
(In thousands except where noted)**

Non-operating Revenue (Expense), Net Fiscal Year 2016

Non-operating expenses, net decreased \$138 thousand to \$250 thousand in 2016. Non-operating items primarily include interest income and interest expense. For 2016, interest income decreased by \$12 thousand, interest expense decreased by \$43 thousand, and net gain/loss on sale of equipment increased by \$107.

Fiscal Year 2015

Non-operating expenses, (net) decreased \$6 thousand to \$388 thousand in 2015. Non-operating items primarily include interest income and interest expense. For 2015, interest income increased by \$15 thousand and interest expense decreased by \$41 thousand, and a net loss on sale of equipment of \$50.

Grants

Fiscal Year 2016

Operating grants in 2016 totaled \$2,061 thousand compared to \$2,663 thousand in 2015. The decrease continues to be mapping grants from the Federal Emergency Management Agency.

Fiscal Year 2015

The increase was from a mapping grant from the Federal Emergency Management Agency.

**Maryland Environmental Service
Management's Discussion and Analysis
June 30, 2016 and 2015
(In thousands except where noted)**

Investment in Capital Assets

The following tables present capital assets, net of depreciation as of June 30, 2016 and 2015, and capital expenditures for the years ended June 30, 2016 and 2015:

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

	2016	2015
Land and improvements	\$ 4,262	\$ 4,262
Buildings and improvements	6,627	7,055
Infrastructure	284	372
Machinery and equipment	7,468	6,850
Total	\$ 18,641	\$ 18,539

**Capital Expenditures
(Expressed in Thousands)**

	2016	2015
Autos and trucks	\$ 868	\$ 1,187
Land	-	3,222
Construction and production equipment	1,235	1,190
Computer hardware/software	127	176
Tools/machinery/equipment	53	-
Leasehold improvements	-	201
Total	\$ 2,283	\$ 5,976

Fiscal Year 2016

As of June 30, 2016, the carrying value of capital assets, net of depreciation was \$18,641 thousand, an increase of \$102 thousand from 2015. The increase is comprised of capital additions of \$2,283 thousand, net disposals of \$32 thousand, and depreciation of \$2,213 thousand. The capital additions for the year were fleet vehicle replacements, JD Edwards ERP system, construction equipment, and the acquisition of land.

Fiscal Year 2015

As of June 30, 2015, the carrying value of capital assets, net of depreciation was \$18,539 thousand, an increase of \$4,060 thousand from 2014. The increase is comprised of capital additions of \$5,976 thousand, net disposals of \$50 thousand, and depreciation of \$1,866 thousand. The capital additions for the year were fleet vehicle replacements, JD Edwards ERP system, construction equipment, and the acquisition of land.

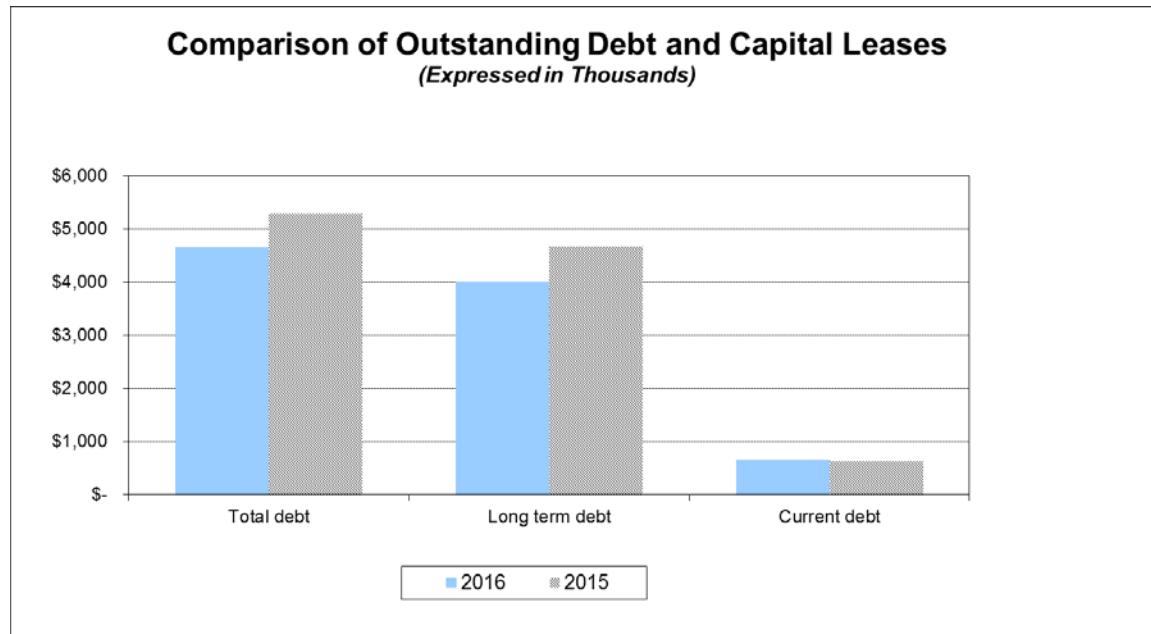
**Maryland Environmental Service
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June 30, 2016 and 2015
(In thousands except where noted)**

Outstanding Debt

The following table and graph present outstanding debt as of June 30, 2016 and 2015:

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

	2016	2015
Capital leases	\$ 4,384	\$ 4,964
General obligation bond / note	273	314
Total	\$ 4,657	\$ 5,278



Fiscal Year 2016

As of June 30, 2016, outstanding debt was \$4,657 thousand, representing a net decrease in borrowing of \$621 from 2015. The net decrease consists of principal payments.

Fiscal Year 2015

As of June 30, 2015, outstanding debt was \$5,278 thousand, representing a net decrease in borrowing of \$590 from 2014. The net decrease consists of principal payments.

**MARYLAND ENVIRONMENTAL SERVICE
FINANCIAL STATEMENT**

Maryland Environmental Service
Statement of Net Position
As of June 30, 2016 and 2015
(Expressed in Thousands)

Assets	2016	2015
Current assets:		
Cash and cash equivalents	\$ 21,409	\$ 48,326
Investments	5,997	10,211
Accounts receivable (net of allowance of \$50)	23,417	16,477
Unbilled project costs accrued	6,137	5,579
Other	130	259
Total current assets	57,090	80,852
Other assets:		
Restricted cash	215	194
Due from project participants	5,123	4,826
Capital assets, net of accumulated depreciation:		
Land	4,262	4,262
Buildings and improvements	6,627	7,055
Infrastructure	284	372
Machinery and equipment	7,468	6,850
Total capital assets	18,641	18,539
Total other assets	23,979	23,559
Total assets	81,069	104,411
Deferred outflows related to pensions	767	331
Liabilities		
Current liabilities:		
Accounts payable and accrued expenses	20,419	14,977
Accrued annual leave	3,060	2,916
Due to Midshore	7,999	13,806
Advances from project participants	14,608	39,535
Current portion of long-term debt and capitalized leases	654	621
Accrued workers' compensation costs	398	436
Total current liabilities	47,138	72,291
Other liabilities:		
Advances from project participants	1,423	1,066
Long-term debt and capitalized leases, net of current portion and bond discount	4,003	4,657
Accrued workers' compensation costs	2,258	2,379
Net Pension Liability	2,968	2,102
Total other liabilities	10,652	10,204
Total liabilities	57,790	82,495
Deferred inflows related to pensions	221	230
Net Position		
Net investment in capital assets	13,985	13,261
Restricted net position	12	12
Unrestricted net position	9,828	8,744
Total net position	\$ 23,825	\$ 22,017

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

Maryland Environmental Service Statement of Revenue, Expenses and Changes in Net Position For the years ended June 30, 2016 and 2015 (Expressed in Thousands)		
	2016	2015
Operating revenue:		
Charges for services	\$ 157,444	\$ 138,510
Operating grants	2,061	2,663
Total operating revenue	159,505	141,173
Operating expenses:		
Salaries and benefits	50,090	44,340
Contractual services	24,068	29,719
Technical fees	10,006	10,342
Utilities	6,501	4,622
Repairs and maintenance	3,952	4,073
Materials and supplies	8,886	12,189
Land, structures and equipment	35,777	17,527
Depreciation	2,213	1,866
General and administrative	14,311	13,746
Other	1,643	911
Total operating expenses	157,447	139,335
Operating income	2,058	1,838
Nonoperating revenue (expenses):		
Investment income	20	32
Interest expense	(344)	(387)
Gain / (loss) on sale of equipment, net	74	(33)
Nonoperating expenses, net	(250)	(388)
Change in net position	1,808	1,450
Net position, beginning of year	22,017	20,567
Net position, end of year	\$ 23,825	\$ 22,017

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

Maryland Environmental Service Statement of Cash Flows For the years ended June 30, 2016 and 2015 <i>(Expressed in Thousands)</i>		
	2016	2015
Cash Flows From Operating Activities		
Receipts from customers	\$ 152,007	140,537
Payments to suppliers	(99,558)	(87,729)
Payments to employees	(50,090)	(44,340)
Payments from project participants	(24,446)	6,409
Other payments project Midshore	(5,807)	(820)
Other	(34)	99
Net cash from operating activities	(27,928)	14,156
Cash Flows From Capital and Related Financing Activities		
Purchases of capital assets	(2,283)	(5,976)
Principal paid on capital debt	(621)	(590)
Interest paid on capital debt	(344)	(387)
Other receipts/disbursements	74	32
Net cash from capital and related financing activities	(3,174)	(6,921)
Cash Flows From Investing Activities		
Purchases of investments	(8,000)	(8,000)
Sales and maturities of investments	12,165	5,803
Interest and dividends	20	34
Net cash from investing activities	4,185	(2,163)
Net changes in cash and cash equivalents	(26,917)	5,072
Cash and cash equivalents - beginning of the year	48,326	43,254
Cash and cash equivalents - end of the year	\$ 21,409	48,326
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 2,058	1,838
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation expense	2,213	1,866
Change in assets and liabilities:		
Receivables, net	(6,939)	1,148
Other assets	(1,167)	(1,573)
Accounts and other payables	5,577	5,399
Due to project participants	(24,570)	6,394
Net Pension Liability	866	(215)
Net change due to/from Midshore	(5,807)	(821)
Accrued workers compensation	(159)	120
Net cash from operating activities	\$ (27,928)	14,156

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

<p style="text-align: center;">Midshore Regional Landfill Private Purpose Trust Fund Statement of Net Position As of June 30, 2016 and 2015 (Expressed in Thousands)</p>		
Assets	2016	2015
Current assets:		
Cash and cash equivalents	\$ 73	\$ 80
Due from MES	7,999	13,806
Accounts receivable	553	567
Total current assets	8,625	14,453
Other assets:		
Restricted investments	2,224	2,230
Capital assets not depreciated	1,690	1,690
Capital assets being depreciated, net	22,841	23,348
Total capital assets	24,531	25,038
Total other assets	26,755	27,268
Total assets	35,380	41,721
Liabilities		
Current liabilities:		
Accounts payable and accrued expenses	1,328	631
Advances from project participants	483	483
Current portion of long-term debt and capitalized leases	1,059	1,020
Total current liabilities	2,870	2,134
Other liabilities:		
Long-term debt and capital leases, net of current portion and bond discount	19,955	21,040
Accrued landfill closure & postclosure care costs	5,187	9,372
Total other liabilities	25,142	30,412
Total liabilities	28,012	32,546
Net Position		
Net investments in capital assets	3,517	2,978
Net assets designated-closure/post closure	2,323	5,522
Net assets designated-Easton	868	867
Unrestricted net position	660	(192)
Total net position	\$ 7,368	\$ 9,175

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

<i>Midshore Regional Landfill Private Purpose Trust Fund</i> <i>Statement of Revenue, Expenses and Changes in Net Position</i> <i>For the years ended June 30, 2016 and 2015</i> <i>(Expressed in Thousands)</i>			
		2016	2015
Operating revenue:			
Charges for services	\$	6,244	\$ 5,803
Operating expenses:			
Salaries and benefits		1,404	1,195
Contractual services		367	310
Technical fees		87	37
Utilities		34	40
Operations and maintenance		361	513
Materials and supplies		119	121
Land, structures and equipment		977	207
Depreciation		692	920
Closure/post closure		2,732	138
General and administrative		457	388
Other, net		28	27
Total operating expenses		7,258	3,896
Operating income		(1,014)	1,907
Nonoperating revenue (expenses):			
Interest income		13	10
Interest expense		(849)	(888)
Gain sale of equipment, net		43	-
Nonoperating expenses, net		(793)	(878)
Change in net position		(1,807)	1,029
Net position, beginning of year		9,175	8,146
Net position, end of year	\$	7,368	\$ 9,175

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

<p style="text-align: center;"><i>Maryland Environmental Service</i> <i>Other Post Employment Benefit Plan</i> <i>Statement of Plan Net Position</i> <i>As of June 30, 2016 and 2015</i> <i>(Expressed in Thousands)</i></p>		
Assets	2016	2015
Cash and short-term investments	\$ 176	\$ 151
Investments:		
Equities	1,342	1,278
Fixed income mutual funds	388	219
Real estate mutual funds	276	352
Other mutual funds	498	501
Total investments	2,504	2,350
Total assets	2,680	2,501
Net position held in trust for other postemployment benefits	\$ 2,680	\$ 2,501

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 years ended June 30, 2016 and 2015 (Expressed in Thousands)		
Additions	2016	2015
Employer contributions	\$ 336	\$ 319
Investment Income:		
Net appreciation in fair value of investments	(140)	(61)
Interests and dividends	62	49
	(78)	(12)
Less investment expense	8	8
Net investment income	(86)	(20)
Total additions	250	299
Deductions		
Benefits paid	71	64
Net increase	179	235
Net position held in trust for other postemployment benefits		
Net position, beginning of year	2,501	2,266
Net position, end of year	\$ 2,680	\$ 2,501

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

Maryland Environmental Service
Notes to Financial Statements
June 30, 2016 and 2015
(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, 2016 and 2015
(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. 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) 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.

Maryland Environmental Service
Notes to Financial Statements
June 30, 2016 and 2015
(In thousands except where noted)

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

(f) Capital Assets (continued)

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 2016 and 2015.

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.

(g) 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.

(h) Pensions

Certain employees of the Service are members of the Maryland State Retirement and Pension System. Employees are members of the Employees Retirement System of the State of Maryland (ERS). ERS is part of the State of Maryland Retirement and Pension System which is considered a single multiple employer cost sharing plan.

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of ERS and additions to/deductions from ERS' fiduciary net position have been determined on the same basis as they are reported by ERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

Maryland Environmental Service
Notes to Financial Statements
June 30, 2016 and 2015
(In thousands except where noted)

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

(h) Pensions (continued)

Deferred Outflows/Inflows of Resources

In addition to assets, the Statement of Net Position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position that applies to a future period(s) and so will not be recognized as an outflow of resources (expense/ expenditure) until then.

In addition to liabilities, the Statement of Net Position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time.

(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 with 30 years of service with the Agency or 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.

Funding Policy. The Service has 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 \$336 thousand in 2016 and 319 thousand in 2015. Total reimbursement of medical expenses was \$71 thousand in 2016 and 64 thousand in 2015.

Annual OPEB Cost and Net Obligation. The Service's annual other post-employment benefit (OPEB) cost (expense) is calculated based on the *annual required contribution of the employer (ARC)*, an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. For the fiscal year ended 2016 and 2015, the Service's annual OPEB cost was \$244 thousand and 248 thousand, respectively.

Maryland Environmental Service
Notes to Financial Statements
June 30, 2016 and 2015
(In thousands except where noted)

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

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

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

OPEB Cost (In Thousands)	2016	2015
Normal cost	\$ 137	\$ 126
Minimum amortization of UAL	91	105
Interest adjustment to year- end	16	17
Annual required contribution / OPEB cost	244	248
Contributions made	(336)	(319)
Increase in net OPEB assets	(92)	(71)
Actuarial change in methods and adjustments	92	71
Net OPEB asset - beginning of year	-	-
Net OPEB asset - end of year	\$ -	\$ -

Funding Status and Funding Process. The funded status of the plan as of July 1, 2015, was as follows (in thousands):

	7/01/2015
Actuarial Valuation date	
Actuarial Value of Assets	\$ 2,500
Actuarial Accrued Liability	4,106
Unfunded Actuarial Liability	1,606
Funded Ratio	60.90 %
Annualized Covered Payroll	\$ 38,420
Ratio of Unfunded Actuarial Liability to Annual Covered Payroll	4.20 %
Net OPEB liabilities as of the valuation date	\$ -

Actuarial Cost Method

Entry age

Maryland Environmental Service
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(1) Organization and Summary of Significant Accounting Policies (continued)

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

As of the valuation date, the plan was 60.9 percent funded. The actuarial accrued liability for benefits was \$4,106 thousand resulting in an unfunded actuarial accrued liability of \$1,606 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, 2015, actuarial valuation, the entry age actuarial cost method was used. The actuarial assumptions included a 7.0% 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. There was no cost in 2016 and 2015.

(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 effective interest method over the contractual term of the bonds.

Maryland Environmental Service
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(1) Organization and Summary of Significant Accounting Policies (continued)

(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, 2016 and 2015, 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

In 2016, the Service adopted Governmental Accounting Standard Board (GASB) Statement No. 72, *Fair Value Measurement and Application*, GASB No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not Within the Scope of GASB Statement 68*, and *Amendments to Certain Provisions of GASB 67 and 68*, GASB No. 76, *the Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, and GASB No. 79, *Certain External Investment Pools and Pool Participants*. There are no significant changes to the financial from the adoption of above GASB statements.

(o) Implementation of Accounting Pronouncement

As of the year ended June 30, 2016, GASB issued GASB No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, GASB No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, GASB No. 77, *Tax Abatement Disclosures*, GASB No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*, GASB No. 80, *Blending Requirements for Certain Component Units – and amendment of GASB Statement No. 14*, GASB No. 81, *Irrevocable Split-Interest Agreements*, and GASB No. 82, *Pension Issues – an amendment of GASB Statements No. 67, No. 68, and No. 73*. These statements may have a material effect on the Service's financial statements once implemented. The Service will be analyzing the effects of these pronouncements and plans to adopt them as applicable by their effective date.

Maryland Environmental Service
Notes to Financial Statements
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(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 \$21,409 thousand as of June 30, 2016. Included, as cash equivalents for financial statement presentation, were certain overnight investments of \$23,015 as of June 30, 2016, 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 effect 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.

The Service categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs.

The Service has the following recurring fair value measurements as of June 30, 2016:

- Bank of America FNMA of \$5,997 and Money market fund of \$2,224 are valued at quoted market price (Level 1 inputs)

As of June 30, 2016, 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	\$ 5,997	\$ 5,995	\$ -	\$ -	\$ -	\$ -
Total		\$5,997	\$5,995	\$ -	\$ -	\$ -	\$ -

Maryland Environmental Service
Notes to Financial Statements
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(In thousands except where noted)

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

As of June 30, 2016, 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	\$ 2,224	\$ 2,224	\$ -	\$ -	\$ -	\$ -

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

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

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

The restricted cash and investments are comprised of the following funds as of June 30, 2016:

Maryland Environmental Service:

	<u>2016</u>	<u>2015</u>
Service held:		
Project restricted	<u>\$ 215</u>	<u>\$ 194</u>

Midshore Regional Landfill:

	<u>2016</u>	<u>2015</u>
Trustee held:		
Interest	\$ -	\$ 4
Closure Fund	764	759
Construction Funds	660	644
Service held:		
Liability Fund	800	823
	<u>\$ 2,224</u>	<u>\$ 2,230</u>

Maryland Environmental Service
Notes to Financial Statements
June 30, 2016 and 2015
(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 (the Plan).

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 \$2,503,710 and \$2,349,550 are uncollateralized and exposed to credit risk as of June 30, 2016 and 2015.

The Service has the following recurring fair value measurements as of June 30, 2016:

- Equities and mutual funds are valued using quoted market prices (Level 1 inputs)

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, 2016, the Plan had the following investments, which represented 5% or more of total investments:

Issue	Fair Value	Percentage
Vanguard Total Stock Market ETF	\$ 556,696	21%
iShares MSCI EAFE Index Fund	496,407	19
Dodge & Cox International Stock Fund	497,822	19
Vanguard Total Bond Index Fund	388,034	14
T Rowe Price Real Estate Fund	276,033	10
Fidelity Investment Money Market	137,769	5

Maryland Environmental Service
Notes to Financial Statements
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(3) Capital Assets (In Thousands)

The tables below represent the changes in capital assets for the year ended June 30, 2016:

Maryland Environmental Service:

2016	Balance 06/30/15	Additions	Deletions	Transfers In/Out	Balance 06/30/16
Capital assets, not depreciated					
Land and improvements	\$ 4,262	\$ -	\$ -	\$ -	\$ 4,262
Capital assets, being depreciated					
Structures and improvements	30,616	-	-	-	30,616
Equipment	17,866	2,283	(1,109)	-	19,040
Total capital assets being depreciated	48,482	2,283	(1,109)	-	49,656
Less: accumulated depreciation for					
Structures and improvements	23,189	515	-	-	23,704
Equipment	11,016	1,698	(1,141)	-	11,573
Total accumulated depreciation	34,205	2,213	(1,141)	-	35,277
Total capital assets, net	\$ 18,539	\$ 70	\$ 32	\$ -	\$ 18,641

Midshore Regional Landfill:

2016	Balance 06/30/15	Additions	Deletions	Transfers In/Out	Balance 06/30/16
Capital assets, not depreciated					
Land and improvements	\$1,690	\$ -	\$ -	\$ -	\$ 1,690
Construction in progress	-	-	-	-	-
Total capital assets, not depreciated	1,690	-	-	-	1,690
Capital assets, being depreciated					
Structures and improvements	39,826	135	-	-	39,961
Equipment	4,430	50	(339)	-	4,141
Total capital assets being depreciated	44,256	185	(339)	-	44,102
Less: accumulated depreciation for					
Structures and improvements	16,664	508	-	-	17,172
Equipment	4,244	184	(339)	-	4,089
Total accumulated depreciation	20,908	692	(339)	-	21,261
Total capital assets, net	\$25,038	(\$507)	\$0	\$ -	\$24,531

Maryland Environmental Service
Notes to Financial Statements
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(In thousands except where noted)

(4) Construction Commitments

There were no new construction commitments outstanding as of June 30, 2016.

(5) Concentrations of Credit

The Service derived approximately 60% of its revenue in 2016 from providing services to the State of Maryland.

(6) 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 \$191 thousand and \$139 thousand for the year ended June 30, 2016 and 2015.

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.

The future minimum lease obligations from capital leases and the net present value of these minimum lease payments as of June 30, 2016, were as follows:

<u>Years ending June 30:</u>	
2017	\$ 842
2018	842
2019	842
2020	842
2021	472
2022-2025	<u>1,495</u>
Total minimum lease payments	5,335
Less: amount representing interest	<u>951</u>
Present value of minimum lease payments	4,384
Less: current portion	611
Long-term portion of capital leases	<u><u>\$ 3,773</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
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(7) Debt (In Thousands)

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

Maryland Environmental Service:

	<u>2016</u>	<u>2015</u>
Bank of America- General Obligation Bond		
Interest at 4.05% and principal due in quarterly installments of \$18 through March 31, 2022.	\$ 273	\$ 314
Less: current portion	<u>43</u>	<u>41</u>
Long-term portion of debt	<u>\$ 230</u>	<u>\$ 273</u>

Future minimum payments for long-term debt as of June 30, 2016, were due as follows:

(In Thousands)			
Years ending June 30:	Total	Principal	Interest
2017	\$ 53	\$ 43	\$ 10
2018	53	45	8
2019	53	47	6
2020	53	48	5
2021	54	51	3
2022	<u>40</u>	<u>39</u>	<u>1</u>
Total	<u>\$ 306</u>	<u>\$ 273</u>	<u>\$ 33</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.

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.

Maryland Environmental Service
Notes to Financial Statements
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(7) Debt (In Thousands) (continued)

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, 2015, such debt service reserve requirements were met, and management believes the Service is in compliance with all other significant requirements of the indentures.

Long-term debt (including current portion) consists of the following as of June 30, 2016 and 2015:

Midshore Regional Landfill:

	<u>2016</u>	<u>2015</u>
Midshore II Regional Landfill Project Revenue Bonds, Series 2011; February 2011		
\$15,080 (plus bond premium of \$455); interest at 3.0% to 5.1% paid semiannually on May 1 and November 1; due in annual installments beginning 2013 through 2030 in varying amounts from \$600 to \$1,385.	\$ 15,535	\$ 16,240
Midshore II Regional Landfill Project Revenue Bonds, Series 2014		
\$4,006 ; interest at 3.14% paid semiannually on May1 and November 1; due in annual installments beginning 2014 trough 2029 in varying amounts from \$247 to \$369	4,006	4,253
Hobbs Road Landfill Closure Project Water Quality Bond, Series 2011A; April 2011		
\$1,473; 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.	1,473	1,567
	<hr/>	<hr/>
Total	21,014	22,060
Less: current portion	<hr/> 1,059	<hr/> 1,020
	<hr/>	<hr/>
Long-term portion of debt	<u>\$ 19,955</u>	<u>\$ 21,040</u>

Maryland Environmental Service
Notes to Financial Statements
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(7) Debt (In Thousands) (continued)

Midshore Regional Landfill:

Future minimum payments for long-term debt as of June 30, 2016, were due as follows

(In Thousands)			
Years ending June 30:	Total	Principal	Interest
2017	\$ 1,913	\$ 1,059	\$ 854
2018	1,914	1,098	816
2019	1,914	1,137	777
2020	1,913	1,182	731
2021	1,912	1,232	680
2022-2026	9,561	7,014	2,547
2027-2031	8,734	7,837	897
	<u>27,861</u>	<u>20,559</u>	<u>7,302</u>
Plus: Unamortized bond premium	<u>455</u>	<u>455</u>	<u>-</u>
Total	<u>\$ 28,316</u>	<u>\$ 21,014</u>	<u>\$ 7,302</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
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(7) Debt (In Thousands) (continued)

Midshore Regional Landfill: (continued)

The Regional Landfill Project Revenue Bond, 2014 Series, was issued in connection with the construction of a new landfill cell to increase the capacity of the Mid-shore II Regional Landfill. The bond constitutes a special obligation of the Service and is payable solely from revenues (tipping fees and supplemental fees) from the project pledged by the Service under Indenture of Trust. Neither the State of Maryland, nor any political subdivision, nor the Service shall be obligated to pay the bond or the interest thereon, except from such project revenues. In the event of any participating county's failure to pay any amounts required under the related Waste Disposal Service Agreement when due, the Service may accept Acceptable Waste generated outside the Mid-shore Counties. In addition, the State Intercept Provision, Md. NR Code Ann., Section 3-108(b), provides that if any local government 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 local government, including a Mid-shore County, by the Comptroller of Maryland shall be paid directly to the Service.

The following table represents changes in long-term liabilities for the years ended June 30, 2016 and 2015 (in thousands):

Maryland Environmental Service:

2016	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Advances from project participants	\$ 40,601	\$ 30,206	\$ (54,776)	\$ 16,031	\$ 14,608
Capitalized leases	4,964	-	(580)	4,384	611
Long-term debt	314	-	(41)	273	43
Workers' compensation	2,815	498	(657)	2,656	398
Net Pension Liability	2,102	866	-	2,968	-
Long-term liabilities	<u>\$ 50,796</u>	<u>\$ 31,570</u>	<u>\$ (56,054)</u>	<u>\$ 26,312</u>	<u>\$ 15,660</u>

2015	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Advances from project participants	\$ 34,207	\$ 44,523	\$ (38,129)	\$ 40,601	\$ 39,535
Capitalized leases	5,514	-	(550)	4,964	580
Long-term debt	354	-	(40)	314	41
Workers' compensation	2,695	120	-	2,815	436
Net Pension Liability	2,317	-	(215)	2,102	-
Long-term liabilities	<u>\$ 45,087</u>	<u>\$ 44,643</u>	<u>\$ (38,934)</u>	<u>\$ 50,796</u>	<u>\$ 40,592</u>

Maryland Environmental Service
Notes to Financial Statements
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(7) Debt (In Thousands) (continued)

Midshore Regional Landfill:

2016	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Long-term debt	\$ 22,060	\$ -	\$ (1,046)	\$ 21,014	\$ 1,059
Landfill closure & post closure care	9,372	2,840	(7,025)	5,187	-
Long-term liabilities	<u>\$ 31,432</u>	<u>\$ 2,840</u>	<u>\$ (8,071)</u>	<u>\$ 26,201</u>	<u>\$ 1,059</u>

2015	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Long-term debt	\$ 23,079	\$ -	\$ (1,019)	\$ 22,060	\$ 1,021
Landfill closure & post closure care	9,818	362	(808)	9,372	-
Long-term liabilities	<u>\$ 32,897</u>	<u>\$ 362</u>	<u>\$ (1,827)</u>	<u>\$ 31,432</u>	<u>\$ 1,021</u>

(8) Unrestricted Net Position

Total unrestricted net position as of June 30, 2016 and 2015, was as follows:

	2016	2015
Total unrestricted net position	<u>\$ 9,828</u>	<u>\$ 8,744</u>

(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.

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(9) Accrued Workers' Compensation Costs

The accrued workers' compensation costs, applicable to the Service's coverage discussed in note 13, 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.

(10) 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 (the 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 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 7% 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 \$336 thousand and \$304 thousand, for the years ended June 30, 2016 and 2015, 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, 2016 and 2015 were \$3,039 thousand and \$1,822 thousand, respectively. Employees are fully vested when eligible for the plan.

Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

As of June 30, 2016, the Service reported a liability of approximately \$2,968 thousand for its proportionate share of the ERS net pension liability. The ERS net pension liability was measured as of June 30, 2015, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The Service's proportion of the ERS net pension liability was based on a projection of the Service's long-term share of contributions to the pension plan relative to the projected contributions of all participating government units, actuarially determined. As of June 30, 2016, the Service's proportion for ERS was 0.0143 percent, which was substantially the same from its proportion measured as of June 30, 2015 of 0.0125 percent.

For the year ended June 30, 2016 and 2015, the Board recognized pension expense for ERS of approximately \$289 thousand and 276 thousand. As of June 30, 2016, the Service reported deferred outflows of resources and deferred inflows of resources related to ERS from the following sources:

Maryland Environmental Service
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(10) Pension (continued)

	Deferred Outflows of Resources	Deferred Inflows of Resources
Changes of actuarial assumption	\$ 170	\$ -
Net difference between projected and actual earnings on pension plan investment	261	161
Net difference between actual and expected experience	-	60
Contributions made subsequent to the measurement date	336	-
Total	<u>\$ 767</u>	<u>\$ 221</u>

The \$336 thousand reported as deferred outflows of resources related to ERS resulting from the Service contributions subsequent to the measurement date will be recognized as a reduction of the ERS net pension liability in the year ended June 30, 2017. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to ERS will be recognized in pension expense as follows:

Years Ending June 30,	Deferred Outflows		Deferred Inflows	
	Net Difference in Investment Earnings	Change in Assumptions	Actual and Expected Experience	Net Difference in Investment Earnings
2017	\$ 65	\$ 38	\$ (12)	\$ (53)
2018	65	38	(12)	(54)
2019	65	38	(12)	(54)
2020	66	31	(12)	-
2021	-	25	(12)	-
Total	<u>\$ 261</u>	<u>\$ 170</u>	<u>\$ (60)</u>	<u>\$ (161)</u>

Actuarial assumptions, long-term expected rate of return on pension plan investments, discount rate, and pension plan fiduciary net position are available at www.sra.state.md.us/Agency/Downloads/CAFR/.

Sensitivity of the Services' proportionate share of the net pension liability to changes in the discount rate.

The Service's proportionate share of the ERS net pension liability calculated using the discount rate of 7.55 percent is \$2,968 thousand. Additionally, the Service's proportionate share of the ERS net pension liability if it were calculated using a discount rate that is 1-percentage-point lower (6.55 percent) is \$4,195 or 1-percentage-point higher (8.55 percent) is \$1,951.

Maryland Environmental Service
Notes to Financial Statements
June 30, 2016 and 2015
(In thousands except where noted)

(11) 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, 2016, management believes it is in compliance with its obligations and has not violated the agreement.

(12) 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 a portion 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, 2016. The landfill stopped accepting waste on December 31, 2010. Total closure and postclosure care costs for the landfill is currently estimated to be \$5,084 thousand, as determined through engineering studies and \$3,127 has been recognized as a liability by the Service as of June 30, 2016.

Midshore II current cells are approximately 15% filled as of June 30, 2016, with a remaining life of 37 years. Total closure and postclosure care costs for the landfill is currently estimated to be \$17,472 thousand, as determined through engineering studies, and \$2,059 thousand has been recognized as a liability by the Service as of June 30, 2016. Costs may be subject to change due to inflation, deflation, technology, and changes in applicable laws and regulations.

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, 2015. The Service expects to satisfy these requirements as of June 30, 2016 using the same criteria.

The Service serves 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.

Maryland Environmental Service
Notes to Financial Statements
June 30, 2016 and 2015
(In thousands except where noted)

(13) 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 9), 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 year ended June 30, 2016 and 2015 was \$4,604 thousand and 4,362 thousand.

Maryland Environmental Service
Required Supplemental Information for Other Postemployment Benefit Plan
(In thousands except where noted)

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

Valuation Date	Value of Assets	Accrued Liability (AAL)	Unfunded AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL as a % of Covered Payroll	
July 1, 2015	\$ 2,500	\$ 4,106	\$ 1,606	60.9%	\$ 38,420	4.2%	
July 1, 2013	1,702	3,483	1781	48.9%	34,048	5.2%	
July 1, 2011	1,111	2,995	1,884	37.1%	32,615	5.8%	
July 1, 2009	-	3,015	3,015	-	34,152	8.8%	

Schedule of Employer Contributions
(In Thousands)
Other Post Employment Benefits

Years Ended	Annual Required Contribution		Annual Contribution		Percentage Contributed	
2016	\$	244	\$	336	138	%
2015		248		319	129	
2014		238		308	129	
2013		224		288	128	
2012		224		271	120	
2011		313		316	101	

Maryland Environmental Service
Required Schedule of Proportionate Share of Net Pension Liability
(In thousands except where noted)

	<u>2016</u>	<u>2015</u>
The Service's proportion of the ERS net pension liability	0.0143%	0.0125%
The Service's proportionate share of the ERS net pension liability	\$ 2,968	\$ 2,102
The Service's covered-employee payroll	\$ 2,483	\$ 2,177
The Service's proportionate share of the net pension liability as a percentage of its covered-employee payroll	120%	97%
Plan fiduciary net position as a percentage of the total pension liability	68.78%	71.87%

This schedule is presented to illustrate the requirement to show information for 10 years. However, information prior to June 30, 2015 is not available.



**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 Service

Report on the Financial Statements

We have audited in accordance with the auditing standards generally accepted in 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 basic financial statements of the Maryland Environmental Service (the Service) as of and for the year ended June 30, 2016, and have issued our report thereon dated September 29, 2016.

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 internal control. Accordingly, we do not express an opinion on the effectiveness of the Service internal control.

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

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



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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 Service'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 Service's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Hunt Valley, Maryland
September 29, 2016



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