U10B00
Maryland Environmental Service

Operating Budget Data

($ in Thousands)

	FY 02 Actual	**FY 03 Working**	**FY 04 Allowance**	**Change**	**% Change Prior Year**
Nonbudgeted Fund	$70,555	$102,039	$65,266	-$36,773	-36%
Total Funds	**$70,555**	**$102,039**	**$65,266**	**-$36,773**	**-36%**

- The Maryland Environmental Service (MES) has made a contribution of $400,000 and will make an additional contribution of $400,000 to the general fund in fiscal 2003 under executive cost containment plans.

- A number of MES projects are scheduled for completion during fiscal 2003, accounting for the projected decrease in the estimated fiscal 2004 budget. Some of the large projects scheduled for completion are Cox Creek Dredged Material Containment Facility, the Dundalk Marine Terminal, the MES crumb rubber facility, and several landfill closures. In addition, the scope of work for several pending projects is not yet fully defined, so MES is not able to budget for them.

Personnel Data

	FY 02 Actual	**FY 03 Working**	**FY 04 Allowance**	**Change**
Regular Positions	560.0	575.1	575.1	0
Contractual FTEs	0	0	0	0
Total Personnel	**560.0**	**575.1**	**575.1**	**0**

Vacancy Data: Regular

Budgeted Turnover: FY 04	n/a	n/a		
Positions Vacant as of 12/31/02	32	5.7%		

Note: Numbers may not sum to total due to rounding.

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Analysis in Brief

Issues

MES Spearheads Largest Product Marketing Enterprise to Date: In January 2003 MES is scheduled to open its biggest business venture to date: a whole scrap tire-to-crumb rubber manufacturing facility. **MES should be prepared to discuss the risks and estimated impact of this start-up business venture.**

Recommended Actions

1. Nonbudgeted.

Updates

Status of MES Recruitment and Retention Efforts: MES experienced a vacancy rate as high as 9.7% in 2001, which prompted the organization to revamp its personnel recruitment and retention policies and procedures. MES has implemented a broad variety of strategies and has adopted new policies to address this situation.

MES Debuts FertileGRO Brand Organic Fertilizer Product: In January 2002 MES debuted an organic fertilizer product produced from chicken litter under the trademark name of FertileGRO Brand and began to sell it in 40-pound bags throughout the mid-Atlantic area. MES anticipates that over the next year this enterprise will remove 6,000 tons of pelletized poultry litter from the Delmarva Peninsula.

Operating Budget Analysis

Program Description

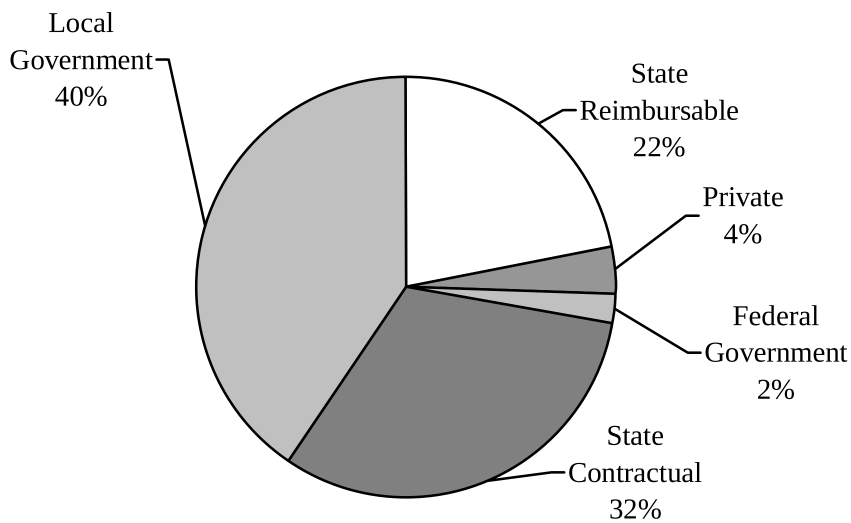
The Maryland Environmental Service (MES) was created as a unit within the Department of Natural Resources (DNR) in 1970 to provide water supply, wastewater treatment, and waste management services to State agencies, local governments, and private entities. During the 1993 session, the General Assembly adopted legislation that created MES as an instrumentality of the State and a public corporation independent of DNR. The organization's primary goals are to improve the environment, work more safely and efficiently, and retain and expand business. MES provides technical services including engineering, design, financing, construction, and operation of water supply and wastewater treatment facilities. MES also provides similar services in the area of hazardous and solid waste facility management, including sanitary landfills, incinerators, and resource recovery facilities. Additional services offered include sludge and dredged materials management, recycling and marketing of end products, and regulatory monitoring. Currently, MES operates over 200 water and wastewater treatment facilities, as well as the Poplar Island environmental restoration project, the Hart-Miller Island Dredged Material Containment Facility, and a regional yard-debris composting facility.

MES operates on a fee-for-service basis. Operating funds are generated from four sources: State agency contracts, local government contracts, federal government contracts, and private contracts. In addition, MES receives State general obligation bond appropriations for capital improvements at State-owned facilities and issues revenue bonds to finance local government projects. Revenues from State agency contracts derive from the operation and maintenance of State-owned water and wastewater treatment plants and from specific projects and services such as environmental cleanup or recycling program management. Revenues from local governments, the federal government, and the private sector derive from the operation and maintenance of water and wastewater treatment facilities and solid waste management services.

Exhibit 1 illustrates the agency's anticipated revenue sources for fiscal 2004. The agency expects to receive 96.2% of its revenue from fees charged to the State and other governments. This includes 40.5% for services provided to other governments, 53.5% for State reimbursable and contractual services, and 2.2% for services to the federal government. Services provided to the private sector account for 3.7% of the agency's total budget. These percentages reflect an anticipated decrease in State contractual funds between fiscal 2003 and 2004.

Exhibit 1

Fiscal 2004 Projected Revenue Source



Source: Maryland Environmental Service

Performance Analysis: Managing for Results

Exhibit 2 outlines the performance data that MES has consistently used to track its performance. Overall, MES exceeded its performance projections. The actual number of billable hours was over 7% higher than estimated, and accident leave was slightly lower than estimated. The actual sales of LeafGRO Brand and compost as well as the amount of used oil collected both exceeded estimates as well. The one measurement that far exceeds projections is corporate and State facility violations measurements. These violations declined by nearly 60% in 2002. MES should consider revising its out year performance estimates for violations, in light of this recent success.

It is not clear how MES intends to measure the success of its two new business enterprise efforts: FertileGRO Brand organic fertilizer and a crumb rubber product. MES should be prepared to discuss how it intends to monitor and measure the performance of these two product development and marketing initiatives.

Exhibit 2

Program Measurement Data
Maryland Environmental Service
Fiscal 1999 through 2004

	Actual 1999	Actual 2000	Actual 2001	Actual 2002	Estimated 2003	Estimated 2004
Billable hours	812,402	832,436	783,639	851,459	870,569	889,679
Accident leave as a percentage of total hours worked	0.190%	0.084%	0.290%	0.026%	0.000%	0.000%
LeafGRO Brand and compost sales	997,000	1,086,000	1,424,000	1,430,000	1,473,000	1,517,000
Used oil collection (1,000 gallons)	784	807	799	840	861	883
Corporate and State facilities violations*	74	51	81	33**	68	68

*Violations based on calendar year.
**As of November 30, 2002.
Source: Maryland Environmental Service

Fiscal 2003 Actions

Impact of Cost Containment

MES contributed $400,000 to the general fund for fiscal 2003 on November 15, 2002. These funds represented unearned revenue from State projects. Unearned revenues occur when project cost estimates exceed actual project costs. MES does not foresee that this transfer will have an adverse impact. MES will contribute an additional $400,000 from unearned revenue, shared use fees, and the elimination of three project reserve funds to the general fund for fiscal 2003. By making this contribution to the general fund and decreasing its working capital, MES will be required to carefully monitor expenditures on projects with up front costs.

MES audited financial statements for the fiscal year ended June 30, 2002, are attached as **Appendix 3** and **Appendix 4**. These statements illustrate that MES is in a positive financial position.

Estimated Budget

The estimated fiscal 2004 budget for MES totals $65.3 million. This represents a 36% decrease from the 2003 working budget. A decrease is typical, since it is difficult for MES to predict new business or changes in the scope of existing contracts. However, the significant size of this decrease illustrates the potential corollary impact reduced State agency contracting could have on MES operations. **Exhibit 3** summarizes the major changes in the agency's budget for fiscal 2004.

Exhibit 3

Governor's Proposed Budget
Maryland Environmental Service
($ in Thousands)

How Much It Grows:	**Nonbudgeted Fund**	**Total**
2003 Working Budget	$102,039	$102,039
2004 Governor's Budget Projection	65,266	65,266
Amount Change	$-36,773	-$36,773
Percent Change	-36%	-36%

Where It Goes:

Personnel Expenses		
3% estimated performance based compensation		$591
Other adjustments		180
Subtotal	**$771**	
State Contractual		
MES Tire Recycling Project – Construction scheduled for completion in fiscal 2003		-3,297
Poplar Island Inspection and Site Development – scheduled for completion in fiscal 2003		-2,621
Maryland Port Administration Environmental Planning and Technical Services – scope of work not yet defined		-1,776
Scrap Tire Amnesty Day and Stockpile Clean-Up – projects not defined for fiscal 2004		-1,406
Cox Creek Construction and Management – project complete in fiscal 2003		-12,566
Dundalk Marine Terminal – construction phase tapering off in fiscal 2004		-3,400

Where It Goes:

State Capital Improvement Projects – based on multiple project timelines..................		-6,117
Scrap Tire Projects – scheduled for completion or not yet defined..............................		-618
DNR Oyster Reef Project – project complete in fiscal 2003		-495
Landfill Closures – projects scheduled for completion in fiscal 2004..........................		-1,783
Town of LaPlata Tornado Debris Clean-Up – project complete in fiscal 2003...........		-388
Other		-3,077
Subtotal	**-$37,544**	
Total		**-$36,773**

Note: Numbers may not sum to total due to rounding.

Issues

1. MES Spearheads Largest Product Marketing Enterprise to Date

Since the mid-eighties, MES has had one marketing enterprise, the production and marketing of LeafGRO Brand and other organic compost. MES produces LeafGRO Brand by composting leaves and grass clippings diverted from local landfills, bagging it, and then selling it to the landscape industry and homeowners. LeafGRO Brand sales have climbed steadily; fiscal 2002 sales reached $1.4 million. Over the past year, MES initiated another enterprise – marketing of FertileGRO Brand organic fertilizer. As described in a subsequent update, MES began bagging and distribution of FertileGRO Brand organic fertilizer in January 2002. While these ventures have provided MES with significant marketing experience, the agency is about to initiate a far more significant production and marketing enterprise.

New Crumb Rubber Manufacturing Facility

In January 2003 MES is scheduled to open its biggest business venture to-date: a whole scrap tire-to-crumb rubber manufacturing facility. MES is planning to open a facility in western Baltimore County that will convert 1.5 million scrap tires – 30% of those generated annually in the State – per year into high quality crumb rubber. The facility will convert tires retrieved from tire companies, solid waste facilities, and junk yards into tiny nuggets of pure rubber, called crumb rubber, which will be sold to manufacturers who, in turn, will use it to make both consumer and industrial products, such as mats, buckets, fence posts, insulation, and sound barriers. The new project will be wholly owned by MES at an investment of $6,000,000 and will hire and train 20 new regular employees to work in two eight-hour shifts a day.

As of December 31, 2002, MES outlays associated with this project total $3.6 million. Of this total outlay, $731,000 is from MES bank accounts and $2.8 million is from an MES bank loan. Lease financing is backed by the full faith and credit of MES and has a taxable interest rate. Current project revenue estimates for fiscal 2003 and 2004 are $1.2 million and $4.0 million.

Of the 5.6 million scrap tires that are generated each year in Maryland, more than 1.5 million, or 27% are used as fuel. Since the Lehigh Portland Cement Company has stopped accepting used tires for fuel, the only remaining large scrap tire processor is overwhelmed. Many tires are being shipped out of the State at a high cost and are not being recycled.

Risks Faced by Start-up Enterprises

Like many start-up efforts to manufacture and sell products, there are several basic risks associated with this effort.

- ***Tire Supply:*** Although there are nearly six million scrap tires generated in Maryland annually, and the tire facility will need to process only 1.5 million tires to meet business projections of the project pro-forma, MES managers will have to make an ongoing concerted effort to ensure that tires arrive at the facility when needed and are processed immediately to avoid potentially serious backlog problems.

- ***Quality:*** The tires will have to be processed into the highest quality crumb rubber product demanded by the marketplace, or it will not be able to be sold at the requisite pro-forma price.

- ***Sales:*** The sales price of crumb rubber fluctuates continuously, making it imperative that MES actively engages in the marketplace to ensure that facility revenue projections are met and inventory backlogs are avoided.

If supply, quality, or sales slip, MES will not be able to meet its financing obligations.

MES should be prepared to discuss the risks and estimated impact of this start-up business venture.

Recommended Actions

1. Nonbudgeted.

Updates

1. Status of MES Recruitment and Retention Efforts

MES experienced a vacancy rate as high as 9.7% in 2001, which prompted the organization to revamp its personnel recruitment and retention policies and procedures. The most difficult to fill positions were equipment operators, mechanics, boiler operators, and environmental operator apprenticeship positions.

Over the past two years, MES sought to address this problem by:

- developing a board composed of representatives from every program within the service that convened weekly to formulate, implement, and evaluate efforts to recruit and retain qualified employees;
- attending job fairs and establishing stronger relationships with employment offices and temporary agencies around the State;
- providing additional compensation for positions located in hard to recruit areas;
- developing an apprentice retention strategy that incorporates mandated training courses, mentors, and monetary training completion incentives;
- decreasing the amount of time it takes for new employees to participate in the Performance Based Compensation plan; and
- reviewing employee salaries on an organizational basis and making appropriate in-grade salary adjustments.

As a result of these efforts, MES has lowered its vacancy rate to 5.7% as of December 2002.

2. MES Debuts FertileGRO Brand Organic Fertilizer Product

In January 2002 MES debuted an organic fertilizer product under the trademark name of FertileGRO Brand and began to sell it in 40-pound bags throughout the mid-Atlantic area. To develop this product, MES is purchasing a pelletized chicken litter product from Perdue AgriRecycle in Seaford, Delaware. Perdue AgriRecycle is a joint venture between Perdue Farms Inc., one of the country's largest poultry companies, and AgriRecycle, a company that developed litter-pelletizing technology. The product was trucked to a temporary bagging plant in Hurlock, which was purchased by the Warrington Foundation through a grant from the U.S. Environmental Protection Agency. Finally, MES stored the packaged product for distribution in a rented space convenient to major transportation routes in Upper Marlboro. MES completed the trial phase of this operation this spring, and then took some time to identify more efficient and effective bagging technology. MES anticipates that over the next year this enterprise will remove over 6,000 tons of pelletized poultry litter from the Delmarva Peninsula.

Appendix 1

Current and Prior Year Budgets

Current and Prior Year Budgets
Maryland Environmental Service
($ in Thousands)

	Nonbudgeted Fund				**Total**
Fiscal 2002					
Estimated Budget	$54,487	$0	$0	$0	$54,487
Change	16,068	0	0	0	16,068
Actual Expenditures	**$70,555**	**$0**	**$0**	**$0**	**$70,555**
Fiscal 2003					
Estimated Budget	$74,062	$0	$0	$0	$74,062
Change	27,977	0	0	0	27,977
Working Budget	**$102,039**	**$0**	**$0**	**$0**	**$102,039**

Note: Numbers may not sum to total due to rounding.

Fiscal 2002 Budget Changes

The significant difference between the estimated budget and the working budget is primarily the result of a tremendous surge in new contracts and expansion of projects in fiscal 2002**.**

Fiscal 2003 Budget Changes

MES has made a contribution of $400,000 and will make an additional contribution of $400,000 to the general fund in fiscal 2003.

Object/Fund Difference Report
Maryland Environmental Service

Object/Fund	FY02 Actual	FY03 Working Budget	FY04 Budget Projection	FY03 - FY04 Amount Change	Percent Change
Positions					
01 Regular	**560.00**	**575.10**	**575.10**	**0**	**0%**
Total Positions	**560.00**	**575.10**	**575.10**	**0**	**0%**
Objects					
01 Salaries and Wages	$ 25,093,078	$ 29,894,123	$ 30,664,881	$ 770,758	2.6%
02 Technical & Spec Fees	5,380,337	5,853,755	1,371,477	-4,482,278	-76.6%
03 Communication	413,130	417,484	401,319	-16,165	-3.9%
04 Travel	157,019	239,299	161,636	-77,663	-32.5%
06 Fuel & Utilities	2,073,275	2,390,891	2,646,289	255,398	10.7%
07 Motor Vehicles	2,176,653	2,615,476	2,314,604	-300,872	-11.5%
08 Contractual Services	12,361,948	14,576,642	9,316,236	-5,260,406	-36.1%
09 Supplies & Materials	5,447,396	7,129,271	5,721,165	-1,408,106	-19.8%
10 Equip - Replacement	2,133,326	612,453	623,883	11,430	1.9%
11 Equip - Additional	5,424,371	5,025,426	1,262,659	-3,762,767	-74.9%
13 Fixed Charges	4,437,234	4,987,366	5,225,506	238,140	4.8%
14 Land & Structures	5,457,573	28,296,732	5,556,593	-22,740,139	-80.4%
Total Objects	**$ 70,555,340**	**$ 102,038,918**	**$ 65,266,248**	**-$36,772,670**	**-36.0%**
Funds					
07 Nonbudgeted Fund	$ 70,555,340	$ 102,038,918	$ 65,266,248	-$36,772,670	-36.0%
Total Funds	**$ 70,555,340**	**$ 102,038,918**	**$ 65,266,248**	**-$36,772,670**	**-36.0%**

Note: Full-time and contractual positions and salaries are reflected for operating budget programs only.

Statement of Revenues, Expenses and Changes in Net Assets
For the year ended June 30, 2002
($ in Thousands)

	Amount
***Operating revenues*:**	
Charges for services	$67,788
Operating expenses:	
Salaries and benefits	20,191
Contractual services	11,786
Technical fees	4,686
Utilities	2,011
Repairs and maintenance	2,058
Materials and supplies	5,141
Land, structures and equipment	10,564
Depreciation	2,028
General and administrative	6,851
Other	962
Total operating expenses	**$66,278**
Operating income	1,510
Nonoperating revenues (expenses):	
Interest income	678
Other revenue	21
Interest expense	-1,780
Nonoperating expenses, net	-1081
Income before contributions	429
Contributions – capital grants	**72**
Change in net assets (see financial statements)	**501**
Net assets, beginning of year	**9,167**
Net assets, end of year	**$9,668**

Source: KPMG LLP

Appendix 4

Statement of Cash Flows
For the year ended June 30, 2002
($ in Thousands)

	Amount
Cash Flows from Operating Activities	
Receipts from customers	$63,860
Payments to suppliers	-40,315
Payments to employees	-20,003
Other receipts (payments) net	1,574
Net cash provided by operating activities	5,116
Cash Flows from Capital and Related Financing Activities	
Proceeds from capital debt	5,391
Capital grants	72
Purchase of capital assets	-1,563
Direct financing lease principal payments received	897
Principal paid on capital debt	-3,288
Interest paid on capital debt	-1715
Other receipts (payments) net	-642
Net cash used by capital and related financing activities	-848
Cash Flows from Investing Activities	
Purchases of investments	-64,831
Sales and maturities of investments	59,439
Interest and dividends	678
Net cash used by investing activities	-4,714
Net decrease in cash and cash equivalents	-446
Cash and cash equivalents – beginning of the year	**732**
Cash and cash equivalents – end of the year	**286**
Reconciliation of operating income to net cash provided by operating activities:	
Operating income	1,510
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation expense	2,220
Change in assets and liabilities:	
Receivables, net	-3,421
Other assets	-407
Accounts and other payables	3,740
Due to/from project participants	1,474
Net cash provided by operating activities	$5,116

Source: KPMG LLP