

**State of Arkansas Construction Assistance  
Revolving Loan Fund Program**

Accountants' Report and Financial Statements

June 30, 2011 and 2010



# State of Arkansas Construction Assistance Revolving Loan Fund Program

June 30, 2011 and 2010

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## Independent Accountants' Report on Financial Statements and Supplementary Information

The Commissioners of the Arkansas Natural  
Resources Commission (ANRC)

The Board of Directors of  
Arkansas Development Finance Authority (ADFA)

We have audited the accompanying basic financial statements of the State of Arkansas Construction Assistance Revolving Loan Fund Program (the Program) as of and for the years ended June 30, 2011 and 2010, as listed in the table of contents. These financial statements are the responsibility of the Program's management. Our responsibility is to express an 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in *Note 1*, the financial statements of the Program are intended to present the financial position, and the results of its operations and cash flows, where applicable, of only that portion of the business-type activities of the State of Arkansas (the State) that is attributable to the transactions of the Program. They do not purport to, and do not, present fairly the financial position of the State as of June 30, 2011 and 2010, and the changes in its financial position and its cash flows, where applicable, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Program as of June 30, 2011 and 2010, and its changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying management's discussion and analysis is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board (GASB). We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

The Commissioners of the Arkansas Natural  
Resources Commission (ANRC)

The Board of Directors of  
Arkansas Development Finance Authority (ADFA)  
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Our audits were conducted for the purpose of forming an opinion on the Program's basic financial statements. The accompanying supplementary information, as listed in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

**BKD, LLP**

*BKD, LLP*

October 27, 2011

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This discussion and analysis is designed to assist the reader in focusing on significant issues and activities and to identify any significant changes in the financial position of the Construction Assistance Revolving Loan Fund Program (the Program). Readers are encouraged to consider the information presented in conjunction with the financial statements and notes as a whole, which follow this section of the report.

***Discussion of Financial Statements***

The June 30, 2011, basic financial statements include three required statements: The statement of net assets; the statement of revenues, expenses and changes in net assets; and the statement of cash flows. Comparative totals as of and for the years ended June 30, 2010 and 2009, are also presented. Although not required, these comparative totals are intended to facilitate an enhanced understanding of the Program's financial position and results of operations for the current fiscal year in comparison to the prior fiscal years. Additional information, following the *Notes to Financial Statements*, includes the combining statement of net assets; the combining statement of revenues, expenses and changes in net assets; as well as the combining statement of cash flows. These combining statements detail the Revolving Loan Fund and the Fees and Expenses Fund, which comprise the Program.

***Condensed Financial Information – Statements of Net Assets***

*(In thousands)*

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Total assets	\$ 332,143	\$ 334,619	\$ 329,412
Current liabilities	11,794	8,041	7,920
Noncurrent liabilities	<u>29,228</u>	<u>51,360</u>	<u>59,193</u>
Total liabilities	<u>41,022</u>	<u>59,401</u>	<u>67,113</u>
Total net assets – restricted for program requirements	\$ <u>291,121</u>	\$ <u>275,218</u>	\$ <u>262,299</u>

The Program's total assets of \$332.1 million at June 30, 2011, reflect a decrease of \$2.5 million from June 30, 2010. At June 30, 2010, the Program's total assets of \$334.6 increased \$5.2 million from June 30, 2009. For the current year, the Program had decreases in investments of \$16.6 million and in loans receivable of \$3.8 million which is offset by increases in cash and cash equivalents of \$17.6 million. In the prior year, the Program had an increase in loans receivable of \$14.1 million which was offset by declines in cash and cash equivalents of \$5.8 million and in investments of \$3.1 million.

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The following table reports loan activity for each year (in thousands):

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Loan disbursements	\$ 17,996	\$ 35,471	\$ 19,019
Loan repayments	<u>21,759</u>	<u>21,412</u>	<u>17,565</u>
Net (decrease) increase in loans receivable	\$ <u>(3,763)</u>	\$ <u>14,059</u>	\$ <u>1,454</u>

The following table reflects the disbursement of funds to new and existing loan borrowers (in thousands):

	<u>2011</u>	<u>2010</u>	<u>2009</u>
New loans	\$ 4,150	\$ 11,256	\$ 27,600
Loan disbursements - new loans	2,376	3,846	3,804
Existing loans	79,596	77,855	63,255
Loan disbursements - existing loans	15,620	31,625	15,215

The Program is continually making loans from federal grant funds from the U.S. Environmental Protection Agency (EPA); and state matching funds and revolving Program funds. The Program received federal funds in the form of an annual capitalization grant (Base) and a 2010 American Recovery and Reinvestment Act (ARRA) grant. In the current year, the Program elected to utilize state matching first, before Base federal funds. In fiscal year 2010, the Program began using ARRA federal grant funds and the Revolving Loan Fund 2009 A Refunding Issue (2009 Issue) principal prepayment funds to make new loans. The table below reflects the amounts used from each funding source for fiscal years 2011, 2010 and 2009 (in thousands):

	<u>2011</u>	<u>2010</u>	<u>2009</u>
EPA Federal			
Base	\$ 2,627	\$ 4,220	\$ 4,220
ARRA	6,585	3,746	-
State matching	2,201	879	879
2009 Issue Prepayment funds	936	1,940	-
Revolving Program funds	<u>5,647</u>	<u>24,686</u>	<u>13,920</u>
	\$ <u>17,996</u>	\$ <u>35,471</u>	\$ <u>19,019</u>

The Program has utilized its cash within the Program as an additional funding source, essentially revolving the assets.

The federal fiscal year 2011 Base grant has been approved by the Environmental Protection Agency in the amount of \$9.7 million and will be available in October 2011.

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The Program's total liabilities decreased to \$41.0 million at June 30, 2011, from \$59.4 million at June 30, 2010, and from \$67.1 million at June 30, 2009. The decrease is attributed to scheduled bond redemptions of \$6.2 million and \$7.2 million, respectively, for fiscal years ended June 30, 2011 and 2010. For the fiscal year ended June 30, 2011, the Program also refunded \$41.0 million 2001 Series A bonds and 2004 Series A bonds with \$11.8 million 2011 Refunding Series A and \$19.4 million in 2011 Refunding Taxable Series B bonds along with other available funds, which resulted in a decline of \$9.8 million in the bonds outstanding.

**Condensed Financial Information – Statements of Revenues, Expenses and Changes in Net Assets**

*(In thousands)*

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Total interest income	\$ 5,858	\$ 6,386	\$ 6,669
Other income	<u>2,502</u>	<u>2,693</u>	<u>2,555</u>
Total operating revenues	<u>8,360</u>	<u>9,079</u>	<u>9,224</u>
Total interest on bonds and notes	2,975	2,891	3,405
Total amortization expense	(264)	44	114
Federal financial assistance	3,836	8,985	-
Administrative expense	<u>267</u>	<u>288</u>	<u>283</u>
Total operating expenses	<u>6,814</u>	<u>12,208</u>	<u>3,802</u>
Operating income (loss)	1,546	(3,129)	5,422
Transfers in (out), net	919	(1,080)	(1,350)
Base federal grants	3,017	4,397	4,397
ARRA federal grants	<u>10,421</u>	<u>12,731</u>	<u>-</u>
Change in net assets	15,903	12,919	8,469
Net assets			
Beginning of year	<u>275,218</u>	<u>262,299</u>	<u>253,830</u>
End of year	<u>\$ 291,121</u>	<u>\$ 275,218</u>	<u>\$ 262,299</u>

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Total operating revenue has continuously decreased over the past three years. In the fiscal year 2011, operating revenue declined \$719,000 as compared with a decline of \$145,000 in fiscal year 2010. During the current year, investment income declined \$322,000, which included arbitrage rebate expense of \$111,000. The interest rate environment is still contributing to the decline in investment income. The Program has liquidated debt service reserve accounts which consisted of guaranteed investment contracts and U. S. agencies obligations with an average interest rate of 4.0%. These liquidated funds were used to extinguish debt of the Program. The \$246,000 decrease in the net depreciation of investments was attributed to the investment of the Program. The Program expects to hold these investments to maturity.

Base federal grants revenue decreased \$1.4 million in the current fiscal year. As of June 30, 2011, the Program had expended \$2.6 million of a \$9.6 million Base federal grants awarded. Information regarding when Base federal grant awards were expended for construction draws is as follows (in thousands):

Federal Award Year	Beginning Balance	Amount Expended in		
		FY2009	FY2010	FY2011
2008	\$ 4,220	\$ 4,220	\$ -	\$ -
2009	4,220	-	4,220	-
2010	9,596	-	-	2,627
		\$ 4,220	\$ 4,220	\$ 2,627

The Program received ARRA federal funding of \$10.4 million. The funds were expended in the form of principal forgiveness and repayable loans as follows (in thousands):

Type of Loans	Amount
Principal forgiveness loans	\$3,836
Repayable loans	6,585

The Program continues to fund loans from other revenue sources including \$8.8 million from the Program funds, state match funds and loan prepayments.

Revenues from investments were \$215,000, \$537,000 and \$777,000 for fiscal years ended June 30, 2011, 2010 and 2009, respectively. The average return on cash, cash equivalents and investments was 0.36%, 0.42% and 1.10% for years ended June 30, 2011, 2010 and 2009, respectively. The Program maintains liquidity to fund projects as needed. Higher cash and cash equivalent balances were maintained during the current and prior years as the Program evaluated liquidity needs and investment options in the current economic climate.



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Operating expenses decreased by \$5.4 million during 2011 as compared to an increase of \$8.4 million during 2010. In fiscal year 2011, the Program expensed \$3.8 million in principal forgiveness loans funded by the ARRA federal grant funds. In fiscal year 2010, the Program expensed \$9.0 million in principal forgiveness loans funded by the ARRA federal grant funds. Program administration expenses totaled \$267,000, \$288,000 and \$283,000 for the fiscal years ended June 30, 2011, 2010 and 2009, respectively. These expenses included amounts paid for audit expense, trustee fees and the administrative fee to the Arkansas Development Finance Authority (ADFA).

Transfers in and out are comprised of transfers to or from other state programs or agencies. In fiscal year 2011, the Program received \$2.0 million from the ANRC Water, Waste Disposal and Pollution Abatement Facilities General Obligation Bond Fund Program for state match. The Program transferred out \$1.1 million to the Arkansas Natural Resources Commission (ANRC) for administrating the Program in the current year. The funding source for the administrative fee is 4% of the EPA capitalization grant along with funds from the Fees and Expenses Fund. In fiscal year 2010, the Program funded state match from funds within the Program and transferred out \$1.1 million to ANRC for administrating the Program.

The net assets of the Program increased \$28.8 million in the past two years. The bond resolutions and the Program restrict all of the net assets.

The overall financial position and results of operations of the Program have improved.

***Contact Regarding the Program***

This financial report is designed to provide bondholders, constituents and business partners with a general overview of the Program's finances and to show the Program's accountability for the funds it administers. Questions about this report and requests for additional financial information should be directed to the ADFA Vice President for Finance and Administration by telephoning 501.682.5900 or by contacting the ANRC Water Development Division Chief at 501.682.1611.

# State of Arkansas Construction Assistance Revolving Loan Fund Program

## Statements of Net Assets

June 30, 2011 and 2010

(In thousands)

	2011	2010
<b>Current Assets</b>		
Cash and cash equivalents	\$ 77,095	\$ 59,535
Accrued interest receivable		
Investments	16	70
Loans	370	388
Accounts receivable		
Borrowers	177	186
Environmental Protection Agency	390	-
Investments – current portion	8,606	17,054
Total current assets	86,654	77,233
<b>Noncurrent Assets</b>		
Investments – restricted	2,752	10,863
Loans receivable – restricted		
Construction	242,169	245,903
Wetlands mitigation	155	184
Other assets	413	436
Total noncurrent assets	245,489	257,386
Total assets	332,143	334,619
<b>Current Liabilities</b>		
Accounts payable	391	271
Accrued interest payable	93	225
Bonds payable – current portion	11,310	7,545
Total current liabilities	11,794	8,041
<b>Noncurrent Liabilities</b>		
Deferred fees	587	792
Bonds payable, net of unamortized premiums (discounts)	28,641	50,568
Total noncurrent liabilities	29,228	51,360
Total liabilities	41,022	59,401
<b>Net Assets</b>		
Restricted for program requirements	\$ 291,121	\$ 275,218

**State of Arkansas Construction Assistance  
Revolving Loan Fund Program**  
**Statements of Revenues, Expenses and Changes in Net Assets**  
**Years Ended June 30, 2011 and 2010**

(In thousands)

	<b>2011</b>	<b>2010</b>
<b>Operating Revenues</b>		
Interest on investments	\$ 215	\$ 537
Interest on loans	5,643	5,849
Financing fees	2,581	2,528
Net (depreciation) appreciation of investments	(85)	161
Other	6	4
Total operating revenues	8,360	9,079
<b>Operating Expenses</b>		
Program administration	267	288
Federal financial assistance	3,836	8,985
Bond interest	2,975	2,891
Amortization of bond issuance costs	104	110
Amortization of bond discounts and premiums	(368)	(66)
Total operating expenses	6,814	12,208
<b>Operating Income (Loss)</b>	1,546	(3,129)
<b>Nonoperating Revenue</b>		
Base federal grants	3,017	4,397
American Recovery and Reinvestment Act federal grants	10,421	12,731
Total nonoperating revenue	13,438	17,128
<b>Income Before Transfers In (Out), Net</b>	14,984	13,999
<b>Transfers In (Out), Net</b>	919	(1,080)
<b>Change in Net Assets</b>	15,903	12,919
<b>Net Assets, Beginning of Year</b>	275,218	262,299
<b>Net Assets, End of Year</b>	\$ 291,121	\$ 275,218

# State of Arkansas Construction Assistance Revolving Loan Fund Program

## Statements of Cash Flows Years Ended June 30, 2011 and 2010

(In thousands)

	2011	2010
<b>Operating Activities</b>		
Interest received on investments	\$ 380	\$ 314
Interest received on loans	5,662	5,776
Financing fee income received	2,385	2,248
Loan disbursements	(17,996)	(35,471)
Principal repayments on loans	21,759	21,412
Cash paid for interest	(2,624)	(2,919)
Federal grant funds expended	(3,836)	(8,985)
Cash paid for program administration	<u>(245)</u>	<u>(276)</u>
Net cash provided by (used in) operating activities	<u>5,485</u>	<u>(17,901)</u>
<b>Noncapital Financing Activities</b>		
Repayment of long-term debt	(50,284)	(7,210)
Proceeds from bond issuance	32,219	-
Cash paid for cost of issuance of long-term debt	(300)	-
Transfers in (out)	919	(1,080)
Nonoperating grants received	<u>13,048</u>	<u>17,128</u>
Net cash (used in) provided by noncapital financing activities	<u>(4,398)</u>	<u>8,838</u>
<b>Investing Activities</b>		
Proceeds from maturities of investments	53,889	38,425
Purchase of investments	<u>(37,416)</u>	<u>(35,195)</u>
Net cash provided by investing activities	<u>16,473</u>	<u>3,230</u>
<b>Increase (Decrease) in Cash and Cash Equivalents</b>	17,560	(5,833)
<b>Cash and Cash Equivalents, Beginning of Year</b>	<u>59,535</u>	<u>65,368</u>
<b>Cash and Cash Equivalents, End of Year</b>	<u>\$ 77,095</u>	<u>\$ 59,535</u>

**State of Arkansas Construction Assistance  
Revolving Loan Fund Program  
Statements of Cash Flows (Continued)  
Years Ended June 30, 2011 and 2010**

(In thousands)

	<b>2011</b>	<b>2010</b>
<b>Reconciliation of Operating Income to Net Cash Provided by (Used In) Operating Activities</b>		
Operating income (loss)	\$ 1,546	\$ (3,129)
Items not requiring (providing) operating activities cash flows		
Amortization of bond issuance costs	104	110
Amortization of bond discounts and premiums	115	(66)
Amortization of deferred financing fees	(205)	(222)
Net depreciation (appreciation) of investments	85	(161)
Changes in		
Accrued interest receivable		
Investments	54	(42)
Loans	18	(72)
Accounts receivable – borrowers	9	(57)
Loans receivable	3,763	(14,059)
Accounts payable	120	(186)
Accrued interest payable	(132)	(28)
Other assets	8	11
Net cash provided by (used in) operating activities	\$ 5,485	\$ (17,901)

# State of Arkansas Construction Assistance Revolving Loan Fund Program

## Notes to Financial Statements

June 30, 2011 and 2010

### Note 1: Nature of Operations and Summary of Significant Accounting Policies

#### *Nature of Operations and Reporting Entity*

The State of Arkansas Construction Assistance Revolving Loan Fund Program (the Program), an enterprise fund of the State of Arkansas, was created pursuant to the 1987 Amendments (P.L.100-4) to the "Clean Water Act" (P.L.92-500) to provide a perpetual fund for financing the construction of wastewater treatment facilities for municipalities and other public entities. The Program is to be capitalized with federal grants from the U.S. Environmental Protection Agency (EPA) and state matching funds on a ratio of five federal dollars to one state dollar.

As of July 2001, Arkansas Natural Resources Commission (ANRC), formerly known as Arkansas Soil and Water Conservation Commission, became the lead agency for the Program (previously led by Arkansas Department of Environmental Quality). As lead agency, ANRC is responsible for performing technical project reviews, monitoring construction, and coordinating the total management of the Program. Act 1243 of 2006 authorized the name change to ANRC, which has not had an impact on the Program. Arkansas Development Finance Authority (ADFA) serves as financial manager for the Program under an interagency agreement. ADFA is responsible for investing and disbursing funds as authorized by the lead agency, servicing loans, preparing and submitting monthly financial reports and annual financial statements, and procuring audit services. ADFA is reimbursed for Program administration costs through a calculation based on loans outstanding in accordance with the interagency agreement. The amounts incurred to ADFA for administration costs for the years ended June 30, 2011 and 2010, were \$201,000 and \$209,000, respectively.

The Arkansas Agriculture Water Quality Loan Program (AAWQLP) is accounted for within the Program. Under the AAWQLP, ANRC establishes noninterest bearing cash accounts with financial institutions. In fiscal year 2007, an agreement was established with AgriBank in which AAWQLP would purchase a noninterest bearing bond in conjunction with loans made by Agribank under the AAWQLP guidelines. Loans are originated by the financial institution or Agribank to the farmers or property owners that provide for the installation of water quality, anti-pollution equipment. Interest income normally earned on these balances at the financial institutions or on the bond is used to reduce the interest rates applicable to the loans obtained by the farmers or other property owners. ANRC has established a Program contribution limit to AAWQLP in the amount of \$25 million. As of June 30, 2011 and 2010, the AAWQLP had \$21.4 million and \$23.6 million, respectively, in deposits and investments with various financial institutions.

#### *Use of Estimates*

The preparation of financial statements in conformity 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 disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change relate to the determination of fair values of investments.

# State of Arkansas Construction Assistance Revolving Loan Fund Program

## Notes to Financial Statements

June 30, 2011 and 2010

### ***Measurement Focus, Basis of Accounting and Financial Statement Presentation***

The Program is accounted for as an enterprise fund for financial reporting purposes and utilizes the economic resource measurement focus and accrual basis of accounting wherein revenues are recognized when earned and expenses when incurred.

Operating revenues and expenses are distinguished from nonoperating items in the Program's statement of revenues, expenses and changes in net assets. Operating revenues and expenses generally result from providing services in connection with the principal ongoing operations. All revenues and expenses not meeting this definition are reported as nonoperating items.

Pursuant to Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Program has elected not to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB) issued after November 30, 1989.

### ***Cash and Cash Equivalents***

The Program considers all liquid investments with original maturities of three months or less to be cash equivalents. At June 30, 2011 and 2010, cash equivalents of \$77.1 million and \$59.5 million, respectively, consisted primarily of money market mutual funds with variable interest rates.

Included in cash equivalents on the Program's statement of net assets is the Fees and Expenses Fund with a balance of approximately \$7.3 million and \$6.8 million at June 30, 2011 and 2010, respectively. This fund contains fees charged on loans of the Program, as allowed by the U.S. EPA. These funds may be used at the discretion of ANRC to fund expenses of the Program.

### ***Investments***

Investments are carried at fair value. Fair value is determined using quoted market prices.

### ***Bond Issuance Costs and Discounts and Premiums***

Costs related to issuing bonds and discounts and premiums on sales of bonds are capitalized and are amortized over the term of the bonds using the effective interest method. Early retirement of bonds results in the acceleration of amortization of bond issuance costs and discounts and premiums.

### ***Financing Fees***

The Program receives monthly financing fees from borrowers. Prior to 2000, the Program charged closing fees that were deferred and are currently being amortized into income ratably over the terms of the bonds outstanding.

# State of Arkansas Construction Assistance Revolving Loan Fund Program

## Notes to Financial Statements

June 30, 2011 and 2010

### ***Net Assets Restricted by Bond Resolution and Program Requirements***

Net assets restricted by bond resolution and program requirements represent funds restricted due to the specific provisions of the Program.

### ***Income Taxes***

As an essential government function of the State of Arkansas, the Program is exempt from income taxes under Section 115 of the Internal Revenue Code and a similar provision of state law.

### ***Reclassifications***

Certain reclassifications have been made to the 2010 financial statements to conform to the 2011 presentation. The reclassifications had no effect on the changes in net assets.

## **Note 2: Deposits and Investments**

### ***Deposits***

Custodial credit risk is the risk that in the event of a bank failure, the Program's deposits may not be returned to it. The Program's deposit policy for custodial credit risk requires compliance with the provisions of state law and bond indentures. Deposits are collateralized for those amounts exceeding federal depository insurance, typically with obligations of the U.S. Treasury, U.S. agencies or instrumentalities or municipal bonds having an aggregate market value at least equal to the amount of the deposits.

At June 30, 2011 and 2010, respectively, \$6.0 million and \$6.2 million of the Program's deposits (and carrying value) of \$12.8 million and \$14.1 million were exposed to custodial credit risk as follows:

*(In thousands)*

	<b>2011</b>	<b>2010</b>
Uninsured and collateral held by pledging financial institution trust department or agent in the Program's name	\$ <u>6,015</u>	\$ <u>6,215</u>



# State of Arkansas Construction Assistance Revolving Loan Fund Program

## Notes to Financial Statements

June 30, 2011 and 2010

### **Investments**

Arkansas statutes and the Program's General Resolution authorizes the Program to invest in direct obligations of the U.S. government; obligations on which the principal and interest are fully guaranteed, or are fully secured, insured, or covered by commitments or agreements to purchase by the U.S. government; obligations of agencies and instrumentalities created by act of the United States Congress and authorized thereby to issue securities or evidence of indebtedness, regardless of guarantee of repayment by the U.S. government; obligations of political subdivisions of the United States; certain obligations issued by the State Board of Education; short-term warrants of political subdivisions of the State of Arkansas and municipalities; the sale of federal funds with a maturity of not more than one business day; demand, savings or time deposits fully insured by a federal deposit insurance agency; repurchase agreements that are fully insured by obligations of the U.S. government, any U.S. state or any political subdivision thereof; securities of, or other interest in, any open-end type investment company or investment trust registered under the Investment Company Act of 1940, and which is considered a money market fund, provided that the portfolio is limited principally to U.S. government obligations and the investment company or trust takes delivery of collateral either directly or through an authorized custodian; guaranteed investment contracts; and bank certificates of deposit.

At June 30, 2011 and 2010, the Program had the following investments and maturities:

<i>(In thousands)</i>	<b>June 30, 2011</b>				
	<b>Fair Value</b>	<b>Maturities in Years</b>			
		<b>Less than 1</b>	<b>1-5</b>	<b>6-10</b>	<b>More than 10</b>
<b>Type</b>					
U.S. Treasury obligations	\$ 2,752	\$ -	\$ 2,752	\$ -	\$ -
U.S. agencies obligations	8,606	8,606	-	-	-
Money market mutual funds	<u>64,266</u>	<u>64,266</u>	<u>-</u>	<u>-</u>	<u>-</u>
	<u>\$ 75,624</u>	<u>\$ 72,872</u>	<u>\$ 2,752</u>	<u>\$ 0</u>	<u>\$ 0</u>

# State of Arkansas Construction Assistance Revolving Loan Fund Program

## Notes to Financial Statements

June 30, 2011 and 2010

(In thousands)

Type	June 30, 2010				
	Fair Value	Maturities in Years			
		Less than 1	1-5	6-10	More than 10
U.S. Treasury obligations	\$ 2,789	\$ -	\$ 2,789	\$ -	\$ -
U.S. agencies obligations	23,032	17,054	4,026	1,952	-
Money market mutual funds	45,394	45,394	-	-	-
Guaranteed investment contracts	<u>2,096</u>	<u>-</u>	<u>2,096</u>	<u>-</u>	<u>-</u>
	<u>\$ 73,311</u>	<u>\$ 62,448</u>	<u>\$ 8,911</u>	<u>\$ 1,952</u>	<u>\$ 0</u>

*Interest Rate Risk* – As a means of limiting its exposure to fair value losses due to rising interest rates, the Program’s investments typically match the term of the corresponding bonds or limits the maturity to expected cash flow needs of the Program.

*Credit Risk* – Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligations. The Program’s investments in U. S. agencies obligations not directly guaranteed by the U. S. government were rated “AAA” by Standard & Poor’s and its investments in money market mutual funds or investments of those funds were rated “AAAm” or “AAA” by Standard & Poor’s and “Aaa” by Moody’s Investors Service.

*Custodial Credit Risk* – For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Program will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. The Program’s investment in mutual funds and guaranteed investment contracts are not classified by custodial credit risk category as they are not evidenced by securities in physical or book entry form.

*Concentration of Credit Risk* – The Program places no limit on the amount that may be invested in any one issuer. Investments of the Program (not guaranteed by the U.S. government or considered mutual funds) representing 5% or more of total investments are as follows (in thousands):

Issuer	Fair Value	Percentage
Federal Farm Credit Bank	\$ 8,606	11%

# State of Arkansas Construction Assistance Revolving Loan Fund Program

## Notes to Financial Statements June 30, 2011 and 2010

### Summary of Carrying Values

The carrying values of deposits and investments are included in the statements of net assets as follows:

*(In thousands)*

	2011	2010
Carrying value		
Deposits	\$ 12,829	\$ 14,141
Investments	75,624	73,311
	\$ 88,453	\$ 87,452
Included in the following statement of		
net assets captions		
Cash and cash equivalents	\$ 77,095	\$ 59,535
Investments – current portion	8,606	17,054
Investments – restricted	2,752	10,863
	\$ 88,453	\$ 87,452

### Note 3: Loans Receivable

The Program originates loans with Arkansas municipalities, sewer improvement districts, and water facilities boards for financing the construction of wastewater treatment facilities. The loans are payable in semi-annual installments. At June 30, 2011 and 2010, such loans had a carrying value of approximately \$242.3 million and \$246.0 million, respectively, of which approximately \$67.3 million and \$60.1 million, respectively, are for projects still under construction. The loans bear interest ranging from 0.0% to 4.0%, and are collateralized by special assessments, by user charges, or by sales and use tax bonds issued by the municipalities, sewer improvement districts and water facilities board.

In fiscal year 2010, the Program began funding loans with American Recovery and Reinvestment Act (ARRA) federal funds. As of June 30, 2011 and 2010, the Program had funded \$10.3 million and \$3.7 million, respectively, in ARRA loans.

Through the years ended June 30, 2011 and 2010, \$454.5 million and \$452.2 million, respectively, in cumulative loans had been approved for funding. At June 30, 2011 and 2010, \$12.8 million and \$26.8 million, respectively, remained encumbered and awaiting disbursement to loan recipients.

# State of Arkansas Construction Assistance Revolving Loan Fund Program

## Notes to Financial Statements

June 30, 2011 and 2010

### Note 4: Bonds Payable

Bonds payable were as follows at June 30:

<i>(In thousands)</i>	Interest Rate Range	Final Maturity Dates	2011	2010
2001-A				
Serial	4.13% – 5.50%	12/1/2017	\$ -	\$ 11,335
Term 1	5.50%	12/1/2013	-	3,170
Term 2	5.50%	12/1/2014	-	3,360
Term 3	5.50%	12/1/2015	-	4,840
Term 4	5.50%	12/1/2018	-	1,750
Term 5	5.50%	12/1/2019	-	1,345
2004-A				
Serial	3.13% – 5.00%	6/1/2015	-	11,400
Term 1	5.00%	12/1/2012	-	3,435
Term 2	5.00%	12/1/2013	-	3,290
Term 3	5.00%	12/1/2014	-	1,925
2009-A				
Serial	2.50% – 4.00%	6/1/2018	10,770	12,060
2011-A				
Serial	2.00% – 4.00%	6/1/2015	11,825	-
2011-B				
Serial Taxable	.75% – 1.20%	6/1/2013	<u>19,400</u>	<u>-</u>
			41,995	57,910
	Unamortized discounts and premiums		<u>(2,044)</u>	<u>203</u>
			<u>\$ 39,951</u>	<u>\$ 58,113</u>

# State of Arkansas Construction Assistance Revolving Loan Fund Program

## Notes to Financial Statements

June 30, 2011 and 2010

Activity in bonds payable for 2011 was as follows:

<i>(In thousands)</i>	<b>Beginning Balance</b>	<b>Additions</b>	<b>Reductions</b>	<b>Ending Balance</b>	<b>Amount Due within One Year</b>
2001-A	\$ 25,800	\$ -	\$ (25,800)	\$ -	\$ -
2004-A	20,050	-	(20,050)	-	-
2009-A	12,060	-	(1,290)	10,770	1,350
2011- A	-	11,825	-	11,825	-
2011-B	<u>-</u>	<u>19,400</u>	<u>-</u>	<u>19,400</u>	<u>9,960</u>
Total bonds payable	<u>\$ 57,910</u>	<u>\$ 31,225</u>	<u>\$ (47,140)</u>	<u>\$ 41,995</u>	<u>\$ 11,310</u>

The principal amount shown above differs from the amount on the statement of net assets due to unamortized discounts and premiums of approximately \$2.0 million.

Activity in bonds payable for 2010 was as follows:

<i>(In thousands)</i>	<b>Beginning Balance</b>	<b>Additions</b>	<b>Reductions</b>	<b>Ending Balance</b>	<b>Amount Due within One Year</b>
2001-A	\$ 28,385	\$ -	\$ (2,585)	\$ 25,800	\$ 2,725
2004-A	23,455	-	(3,405)	20,050	3,530
2009-A	<u>13,280</u>	<u>-</u>	<u>(1,220)</u>	<u>12,060</u>	<u>1,290</u>
Total bonds payable	<u>\$ 65,120</u>	<u>\$ 0</u>	<u>\$ (7,210)</u>	<u>\$ 57,910</u>	<u>\$ 7,545</u>

The principal amount shown above differs from the amount on the statement of net assets due to unamortized discounts and premiums of approximately \$203,000.

# State of Arkansas Construction Assistance Revolving Loan Fund Program

## Notes to Financial Statements

June 30, 2011 and 2010

Annual debt service requirements to maturity for bonds payable are as follows:

<i>(In thousands)</i>	Principal	Interest
Fiscal Year ending June 30,		
2012	\$ 11,310	\$ 1,016
2013	11,320	878
2014	11,110	706
2015	3,250	284
2016	1,600	158
2017-2021	3,405	154
	41,995	3,196
Unamortized discounts and premiums	(2,044)	-
	<u>\$ 39,951</u>	<u>\$ 3,196</u>

During the current year, ADFA issued \$31.2 million in 2011 Refunding Series A and 2011 Refunding Taxable Series B bonds for the benefit of the Program. The proceeds from the sale of the Series Refunding A bonds, along with other funds, were used to current refund all the outstanding 2004 Series A bonds on June 1, 2011, and to pay underwriters compensation and other costs of issuance. With the issuance of the 2011 Refunding Taxable Series B bonds, the Program defeased all the outstanding 2001 Series A bonds. The proceeds from the bonds, along with other funding sources, were deposited in trust under an escrow agreement sufficient in amount to pay principal and interest on the defeased bonds on May 26, 2011 and were used to pay underwriters compensation and other costs of issuance. The advance refunding resulted in an extinguishment of debt since the Program was legally released from its obligation on the 2001 Series A bonds at the time of defeasance.

The refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of \$3.5 million. This difference, reported in the accompanying financial statements as a deduction from bonds payable, is being charged to operations through the year 2015 using the effective-interest method. The Program completed the refunding to reduce its total debt service payments over the next 7 years by \$9.8 million and to obtain a present value benefit (difference between the present values of the old and new debt service payments) of \$1.6 million for the Program.

### Note 5: Significant Estimates and Concentrations

Accounting principles generally accepted in the United States of America require disclosure of certain significant estimates and current vulnerabilities due to certain concentrations. Those matters include the following:

# State of Arkansas Construction Assistance Revolving Loan Fund Program

## Notes to Financial Statements

June 30, 2011 and 2010

### ***Economic Dependency***

The Program has been economically dependent upon revenue from EPA. The impact of the revenue varies from year to year, and, for the year ended June 30, 2011 and 2010, the Program received 62% and 65% respectively of total revenue in the form of federal grants. In the current year, the Program has disbursed \$10.4 million of the ARRA grant funds and \$3.0 million of Base grant funds. As of June 30, 2011, \$7.0 million of the \$10.0 million fiscal year 2010 Base grant is still to be disbursed.

The Program recognizes that the goal of the ARRA grants is to expeditiously fund eligible projects that will simultaneously create jobs, promote economic recovery, and generate long term benefits from infrastructure investment. The ARRA guidelines require that not less than 50% of assistance provided be additional subsidies in the form of principal forgiveness loans. ARRA also requires that, to the extent there are sufficient eligible project applications, not less than 20% of the funds be used for a Green Project Reserve. Projects must be one of the following: water or energy efficient, green infrastructure, or other environmentally innovative activities. The Program has \$2.5 million in ARRA federal revenue to be disbursed in future fiscal years.

### ***Contingencies***

The Program is capitalized by state and federal grant programs, which are governed by various rules and regulations of the grantor agencies. Costs charged to the respective grant programs are subject to audit and adjustments by the grantor agencies; therefore, to the extent that the Program has not complied with the rules and regulations governing the grants, refunds of any money received may be required, and the collectability of any related receivable may be impaired. In the opinion of the management of the Program, there are no significant contingent liabilities relating to compliance with the rules and regulations governing the respective grants; therefore, no provision has been recorded in the accompanying financial statements for such a contingency.

In conjunction with the issuance of tax-exempt bonds, the Internal Revenue Code of 1986 establishes rules and regulations for arbitrage rebates. The Program has made provisions for revenues above the rebate limit, which must be remitted to the Federal Government.

## **Supplementary Information**



**State of Arkansas Construction Assistance  
Revolving Loan Fund Program  
Combining Statement of Net Assets  
June 30, 2011**

(In thousands)

	<b>Revolving Loan Fund</b>	<b>Fees and Expenses</b>	<b>Total</b>
<b>Current Assets</b>			
Cash and cash equivalents	\$ 69,842	\$ 7,253	\$ 77,095
Accrued interest receivable			
Investments	-	16	16
Loans	370	-	370
Accounts receivable			
Borrowers	-	177	177
Environmental Protection Agency	-	390	390
Investments – current portion	<u>8,606</u>	<u>-</u>	<u>8,606</u>
Total current assets	<u>78,818</u>	<u>7,836</u>	<u>86,654</u>
<b>Noncurrent Assets</b>			
Investments – restricted	-	2,752	2,752
Loans receivable – restricted			
Construction	242,169	-	242,169
Wetlands mitigation	155	-	155
Other assets	<u>413</u>	<u>-</u>	<u>413</u>
Total noncurrent assets	<u>242,737</u>	<u>2,752</u>	<u>245,489</u>
Total assets	<u>321,555</u>	<u>10,588</u>	<u>332,143</u>
<b>Current Liabilities</b>			
Accounts payable	189	202	391
Accrued interest payable	93	-	93
Bonds payable – current portion	<u>11,310</u>	<u>-</u>	<u>11,310</u>
Total current liabilities	<u>11,592</u>	<u>202</u>	<u>11,794</u>
<b>Noncurrent Liabilities</b>			
Deferred fees	13	574	587
Bonds payable, net of unamortized premiums (discounts)	<u>28,641</u>	<u>-</u>	<u>28,641</u>
Total noncurrent liabilities	<u>28,654</u>	<u>574</u>	<u>29,228</u>
Total liabilities	<u>40,246</u>	<u>776</u>	<u>41,022</u>
<b>Net Assets</b>			
Restricted for program requirements	<u>\$ 281,309</u>	<u>\$ 9,812</u>	<u>\$ 291,121</u>

**State of Arkansas Construction Assistance  
Revolving Loan Fund Program**  
Combining Statement of Revenues, Expenses and Changes in Net Assets  
Year Ended June 30, 2011

<i>(In thousands)</i>	<b>Revolving Loan Fund</b>	<b>Fees and Expenses</b>	<b>Total</b>
<b>Operating Revenues</b>			
Interest on investments	\$ 167	\$ 48	\$ 215
Interest on loans	5,643	-	5,643
Financing fees	14	2,567	2,581
Net depreciation of investments	(68)	(17)	(85)
Other	<u>6</u>	<u>-</u>	<u>6</u>
Total operating revenues	<u>5,762</u>	<u>2,598</u>	<u>8,360</u>
<b>Operating Expenses</b>			
Program administration	7	260	267
Federal financial assistance	3,836	-	3,836
Bond interest	2,975	-	2,975
Amortization of bond issuance costs	104	-	104
Amortization of bond discounts and premiums	<u>(368)</u>	<u>-</u>	<u>(368)</u>
Total operating expenses	<u>6,554</u>	<u>260</u>	<u>6,814</u>
<b>Operating (Loss) Income</b>	<u>(792)</u>	<u>2,338</u>	<u>1,546</u>
<b>Nonoperating Revenue</b>			
Base federal grants	2,627	390	3,017
American Recovery and Reinvestment Act federal grants	<u>10,421</u>	<u>-</u>	<u>10,421</u>
Total nonoperating revenue	<u>13,048</u>	<u>390</u>	<u>13,438</u>
<b>Income Before Transfers In (Out)</b>	12,256	2,728	14,984
<b>Transfers In (Out)</b>	<u>2,871</u>	<u>(1,952)</u>	<u>919</u>
<b>Change in Net Assets</b>	15,127	776	15,903
<b>Net Assets, Beginning of Year</b>	<u>266,182</u>	<u>9,036</u>	<u>275,218</u>
<b>Net Assets, End of Year</b>	<u>\$ 281,309</u>	<u>\$ 9,812</u>	<u>\$ 291,121</u>

**State of Arkansas Construction Assistance  
Revolving Loan Fund Program  
Combining Statement of Cash Flows  
Year Ended June 30, 2011**

<i>(In thousands)</i>	<b>Revolving Loan Fund</b>	<b>Fees and Expenses</b>	<b>Total</b>
<b>Operating Activities</b>			
Interest received on investments	\$ 330	\$ 50	\$ 380
Interest received on loans	5,662	-	5,662
Financing fee income received	-	2,385	2,385
Loan disbursements	(17,996)	-	(17,996)
Principal repayments on loans	21,759	-	21,759
Cash paid for interest	(2,624)	-	(2,624)
Federal grant funds expended	(3,836)	-	(3,836)
Cash received (paid) for program administration	<u>22</u>	<u>(267)</u>	<u>(245)</u>
Net cash provided by operating activities	<u>3,317</u>	<u>2,168</u>	<u>5,485</u>
<b>Noncapital Financing Activities</b>			
Repayment of long-term debt	(50,284)	-	(50,284)
Proceeds from bond issuance	32,219	-	32,219
Cash paid for cost of issuance of long-term debt	(300)	-	(300)
Transfers in (out)	2,871	(1,952)	919
Nonoperating grants received	<u>13,048</u>	<u>-</u>	<u>13,048</u>
Net cash used in noncapital financing activities	<u>(2,446)</u>	<u>(1,952)</u>	<u>(4,398)</u>
<b>Investing Activities</b>			
Proceeds from maturities of investments	43,889	10,000	53,889
Purchase of investments	<u>(27,671)</u>	<u>(9,745)</u>	<u>(37,416)</u>
Net cash provided by investing activities	<u>16,218</u>	<u>255</u>	<u>16,473</u>
<b>Increase in Cash and Cash Equivalents</b>	17,089	471	17,560
<b>Cash and Cash Equivalents, Beginning of Year</b>	<u>52,753</u>	<u>6,782</u>	<u>59,535</u>
<b>Cash and Cash Equivalents, End of Year</b>	<u>\$ 69,842</u>	<u>\$ 7,253</u>	<u>\$ 77,095</u>

**State of Arkansas Construction Assistance  
Revolving Loan Fund Program  
Combining Statement of Cash Flows (Continued)  
Year Ended June 30, 2011**

<i>(In thousands)</i>	<b>Revolving Loan Fund</b>	<b>Fees and Expenses</b>	<b>Total</b>
<b>Reconciliation of Operating Income to Net Cash Provided By Operating Activities</b>			
Operating (loss) income	\$ (792)	\$ 2,338	\$ 1,546
Items not requiring (providing) operating activities cash flows			
Amortization of bond issuance costs	104	-	104
Amortization of bond discounts and premiums	115	-	115
Amortization of deferred financing fees	(14)	(191)	(205)
Net depreciation of investments	68	17	85
Changes in			
Accrued interest receivable			
Investments	51	3	54
Loans	18	-	18
Accounts receivable – borrowers	-	9	9
Loans receivable	3,763	-	3,763
Accounts payable	128	(8)	120
Accrued interest payable	(132)	-	(132)
Other assets	<u>8</u>	<u>-</u>	<u>8</u>
Net cash provided by operating activities	<u>\$ 3,317</u>	<u>\$ 2,168</u>	<u>\$ 5,485</u>