

State of Arkansas Drinking Water Revolving Loan Fund Program

Accountants' Report and Financial Statements

June 30, 2003 and 2002



**State of Arkansas Drinking Water Revolving Loan
Fund Program
June 30, 2003 and 2002**

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State of Arkansas Safe Drinking Water Fund Management's Discussion and Analysis

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 Safe Drinking Water Fund Program (the "Program"). Readers are encouraged to consider the information presented in conjunction with the financial statements as a whole, which follow this section of the report.

Discussion of Financial Statements

The 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 year ended June 30, 2002, are also presented. 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 prior fiscal year. Additional information, following the Notes to the Combined 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, the Fees and Expenses, and the Department of Health Set Aside, which comprise the Program.

Condensed Financial Information – Statement of Net Assets

(In Thousands)

	2003	2003
Total assets	\$ <u>23,459</u>	\$ <u>16,142</u>
Current liabilities	1,415	1,411
Noncurrent liabilities	<u>906</u>	<u>552</u>
Total liabilities	<u>2,321</u>	<u>1,963</u>
Total net assets – restricted by program requirements	\$ <u><u>21,138</u></u>	\$ <u><u>14,179</u></u>

The Program's total assets increased 45.3% to \$23.4 million at June 30, 2003, compared to \$16.1 million at June 30, 2002. The increase is primarily attributed to the funding of \$2.26 million of the \$13.2 million in new loans approved during the year as well as disbursements of \$3.89 million related to existing loans. The Program issued three new loans for fiscal year 2003 to the City of Murfreesboro, the City of Nashville and the City of Wynne. The construction period for the loans of the Program is approximately two years. The accounts receivable balance of \$1.41 million includes \$1.39 million amount due from the Environment Protection Agency for the reimbursement of expenses incurred by the Department of Health and paid by the Program.

The Program's total liabilities increased 18.2% to \$2.3 million at June 30, 2003, from \$2.0 million at June 30, 2002. The increase is primarily attributed to the accrual for the program administration expenses of \$1.39 million. The deferred fee balance increased \$354 thousand to \$906 thousand in fiscal year 2003. The balance increase is attributable to the 3% loan-closing fee received by the Program that is amortized over the life of the loan.

State of Arkansas Safe Drinking Water Fund Management's Discussion and Analysis (Continued)

Condensed Financial Information – Statement of Revenues, Expenses and Changes in Net Assets *(In thousands)*

	2003	2002
Total investment income	\$ 399	\$ 299
Other income	<u>410</u>	<u>80</u>
Total operating revenues	809	379
Administrative expenses	<u>41</u>	<u>295</u>
Operating income	768	84
Transfer out	(2,984)	(1,464)
Federal grants	<u>9,175</u>	<u>3,265</u>
Change in net assets	6,959	1,885
Net assets		
Beginning of year	<u>14,179</u>	<u>12,294</u>
End of year	<u>\$ 21,138</u>	<u>\$ 14,179</u>

The change in net assets of \$6.96 million for the year ending June 30, 2003, increased \$5.07 million compared to fiscal year 2002. This is attributable to the increase in the amount of federal grants received due to the use of federal dollars by the Program. Included in the total investment income is interest received on loans, which increased 88.1% to \$333 thousand in fiscal year 2003, from \$177 thousand in the previous year. The attributing factor to the increase is the continuous funding of loans at a faster pace than repayments in the Program. Also, during the construction phase each municipality remits interest semi-annually on the outstanding loan balance. Revenues from investments declined \$56 thousand, with the average return on cash and cash equivalents of 1.2% in 2003 compared to 2.3% in 2002.

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

Independent Accountants' Report on Financial Statements and Supplementary Information

The Commissioners of the Soil and Water
Conservation Commission

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

We have audited the accompanying statement of net assets of the State of Arkansas Drinking Water Revolving Loan Fund Program (the "Program") as of June 30, 2003, and the related statements of revenues, expenses and changes in net assets, and cash flows for the year then ended. 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 audit. The financial statements of the Program as of June 30, 2002, were audited by other accountants whose report dated October 9, 2002, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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 audit provides 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, 2003 and 2002, 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 2003 financial statements referred to above present fairly, in all material respects, the financial position of the Program as of June 30, 2003, its changes in financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Commissioners of the Soil and Water
Conservation Commission

The Board of Directors of
Arkansas Development Finance Authority (“ADFA”)
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In accordance with *Government Auditing Standards*, we have also issued our report dated September 18, 2003, on our consideration of the Program’s internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The accompanying management’s discussion and analysis as listed in the table of contents is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted primarily 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 accompanying supplementary information 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 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.

/s/ **BKD, LLP**

Little Rock, Arkansas
September 18, 2003

**State of Arkansas Drinking Water Revolving Loan
Fund Program
Statements of Net Assets
June 30, 2003 and 2002**

	2003	2002
<i>In thousands</i>		
Current Assets		
Cash and cash equivalents	\$ 6,085	\$ 4,973
Accrued interest receivable	46	7
Accounts receivable	1,407	1,139
Total current assets	7,538	6,119
Noncurrent Assets		
Loans receivable – restricted	15,921	10,023
Total assets	23,459	16,142
Current Liabilities		
Accounts payable	1,415	1,411
Noncurrent Liabilities		
Deferred fees	906	552
Total liabilities	2,321	1,963
Net Assets		
Restricted for program requirements	\$ 21,138	\$ 14,179

State of Arkansas Drinking Water Revolving Loan Fund Program

Statements of Revenues, Expenses and Changes in Net Assets Years Ended June 30, 2003 and 2002

In thousands

	2003	2002
Operating Revenues		
Interest on investments	\$ 66	\$ 122
Interest on loans	333	177
Financing fees	155	80
Other	255	—
Total operating revenues	809	379
Operating Expenses		
Program administration	41	295
Operating Income	768	84
Nonoperating Income		
Federal grants	9,175	3,265
Income Before Transfers Out	9,943	3,349
Transfers Out	(2,984)	(1,464)
Change in Net Assets	6,959	1,885
Net Assets, Beginning of Year	14,179	12,294
Net Assets, End of Year	\$ 21,138	\$ 14,179

**State of Arkansas Drinking Water Revolving Loan
Fund Program
Statements of Cash Flows
Years Ended June 30, 2003 and 2002**

In thousands

	2003	2002
Operating Activities		
Interest received on loans and investments	\$ 360	\$ 313
Loan disbursements	(6,113)	(3,853)
Principal payments on loans	215	100
Financing fees	492	339
Cash paid for program administration	(33)	(30)
Net cash used in operating activities	(5,079)	(3,131)
Noncapital Financing Activities		
Transfers out	(2,732)	(1,464)
Nonoperating grants received	8,923	3,265
Net cash provided by noncapital financing activities	6,191	1,801
Increase (Decrease) in Cash and Cash Equivalents	1,112	(1,330)
Cash and Cash Equivalents, Beginning of Year	4,973	6,303
Cash and Cash Equivalents, End of Year	\$ 6,085	\$ 4,973
Reconciliation of Operating Income to Net Cash Provided By		
Operating Activities		
Operating income	\$ 768	\$ 84
Items not requiring (providing) operating activities cash flows		
Depreciation and amortization	(23)	8
Changes in		
Accrued interest receivable	(39)	14
Accounts receivable	(268)	(1,139)
Loans receivable	(5,898)	(3,753)
Accounts payable	4	1,396
Deferred fees	377	259
Net cash used in operating activities	\$ (5,079)	\$ (3,131)

State of Arkansas Drinking Water Revolving Loan Fund Program

Notes to Financial Statements June 30, 2003 and 2002

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

Nature of Operations and Reporting Entity

Act 772 of 1997 (the "Act") authorized the establishment of a fund known as the Safe Drinking Water Fund (the "Program") to be maintained by the Arkansas Development Finance Authority ("ADFA"), and administered by the Arkansas Soil and Water Conservation Commission (the "Commission"). The Program is to be capitalized with federal grants, state matching grants, other grants, proceeds of bonds issued by ADFA or the Commission for the Program, and loan principal, interest and fees charged to administer the program. These funds may be loaned for water system projects, pledged and used to pay debt service and related costs, used to pay administrative expenses and provide technical assistance for the Program, and used for other purposes related to the program.

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.

Accounting Method

The Program utilizes the proprietary fund method of accounting whereby operating revenues and expenses are distinguished from nonoperating items. 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. All revenues and expenses are recognized on the accrual basis. 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, unless the GASB specifically adopts such FASB Statements or Interpretations. The Program first applies restricted net assets when an expense or outlay is incurred for purposes for which both restricted and unrestricted net assets are available.

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, 2003 and 2002, cash equivalents of approximately \$6.1 million and \$5.0 million, respectively, consisted primarily of money market mutual funds with variable interest rates.

State of Arkansas Drinking Water Revolving Loan Fund Program

Notes to Financial Statements June 30, 2003 and 2002

Loan Receivables

The Program originates loans with Arkansas municipalities for financing the construction of drinking water treatment facilities. These loans are payable in semi-annual installments. At June 30, 2003 and 2002, such loans had a carrying value of approximately \$15.9 million and \$10.0 million, respectively. The loans bear interest at 2.5% to 2.9%, and are collateralized by special assessments, by user charges or by sales and use tax bonds issued by the municipalities.

Through the year ended June 30, 2003, approximately \$33.1 million had cumulatively been approved for funding. At June 30, 2003, approximately \$16.8 million remained encumbered and awaiting disbursement to loan recipients.

Net Assets Restricted by Program Requirements

Represents 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 2002 financial statements to conform to the 2003 financial statement presentation. These reclassifications had no effect on net assets.

Note 2: 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:

Economic Dependency

The Program is economically dependent upon revenue from the Environmental Protection Agency. During 2003 and 2002, the Program received over 92% and 90%, respectively, of total revenue in the form of federal grants.

Contingency

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 collectibility of any related receivable at June 30, 2003 and 2002, 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.

Supplementary Information

**State of Arkansas Drinking Water Revolving Loan
Fund Program
Combining Statement of Net Assets
June 30, 2003**

<i>In thousands</i>	Department of Health Set Aside	Fees and Expenses	Revolving Loan Fund	Total
Current Assets				
Cash and cash equivalents	\$ 3	\$ 785	\$ 5,297	\$ 6,085
Accrued interest receivable	—	1	45	46
Accounts receivable	<u>1,391</u>	<u>16</u>	<u>—</u>	<u>1,407</u>
Total current assets	1,394	802	5,342	7,538
Noncurrent Assets				
Loans receivable – restricted	<u>—</u>	<u>—</u>	<u>15,921</u>	<u>15,921</u>
Total assets	<u>1,394</u>	<u>802</u>	<u>21,263</u>	<u>23,459</u>
Current Liabilities				
Accounts payable	1,391	23	1	1,415
Noncurrent Liabilities				
Deferred fees	<u>—</u>	<u>906</u>	<u>—</u>	<u>906</u>
Total liabilities	<u>1,391</u>	<u>929</u>	<u>1</u>	<u>2,321</u>
Net Assets				
Restricted for program requirements	<u>\$ 3</u>	<u>\$ (127)</u>	<u>\$ 21,262</u>	<u>\$ 21,138</u>

**State of Arkansas Drinking Water Revolving Loan
Fund Program**
Combining Statement of Revenues, Expenses and Changes in Net Assets
Year Ended June 30, 2003

<i>In thousands</i>	Department of Health Set Aside	Fees and Expenses	Revolving Loan Fund	Total
Operating Revenues				
Interest on investments	\$ —	\$ 6	\$ 60	\$ 66
Interest on loans	—	—	333	333
Amortization of financing fees	—	155	—	155
Other	<u>—</u>	<u>253</u>	<u>2</u>	<u>255</u>
Total operating revenues	0	414	395	809
Operating Expenses				
Program administration	<u>—</u>	<u>41</u>	<u>—</u>	<u>41</u>
Operating Income	0	373	395	768
Nonoperating Income				
Federal grants	<u>2,652</u>	<u>76</u>	<u>6,447</u>	<u>9,175</u>
Income Before Transfers Out	2,652	449	6,842	9,943
Transfers Out	<u>(2,652)</u>	<u>(44)</u>	<u>(288)</u>	<u>(2,984)</u>
Change in Net Assets	0	405	6,554	6,959
Net Assets, Beginning of Year	<u>3</u>	<u>(532)</u>	<u>14,708</u>	<u>14,179</u>
Net Assets, End of Year	<u>\$ 3</u>	<u>\$ (127)</u>	<u>\$ 21,262</u>	<u>\$ 21,138</u>

State of Arkansas Drinking Water Revolving Loan Fund Program

Combining Statement of Cash Flows Year Ended June 30, 2003

	Department of Health Set Aside	Fees and Expenses	Revolving Loan Fund	Total
Operating Activities				
Interest received on loans and investments	\$ —	\$ 5	\$ 355	\$ 360
Loan disbursements	—	—	(6,113)	(6,113)
Principal payments on loans	—	—	215	215
Financing fees	—	492	—	492
Cash paid for program administration	<u>—</u>	<u>(33)</u>	<u>—</u>	<u>(33)</u>
Net cash provided by operating activities	<u>0</u>	<u>464</u>	<u>(5,543)</u>	<u>(5,079)</u>
Noncapital Financing Activities				
Transfers out	(2,400)	31	(363)	(2,732)
Nonoperating grants received	<u>2,400</u>	<u>—</u>	<u>6,523</u>	<u>8,923</u>
Net cash provided by noncapital financing activities	<u>0</u>	<u>31</u>	<u>6,160</u>	<u>6,191</u>
Increase in Cash and Cash Equivalents	0	495	617	1,112
Cash and Cash Equivalents, Beginning of Year	<u>3</u>	<u>290</u>	<u>4,680</u>	<u>4,973</u>
Cash and Cash Equivalents, End of Year	<u>\$ 3</u>	<u>\$ 785</u>	<u>\$ 5,297</u>	<u>\$ 6,085</u>

**State of Arkansas Drinking Water Revolving Loan
Fund Program
Combining Statement of Cash Flows (Continued)
Year Ended June 30, 2003**

**Reconciliation of Operating
Income to Net Cash
Provided By Operating
Activities**

Operating income	\$	—	\$	373	\$	395	\$	768
Items not providing operating activities cash flows								
Depreciation and amortization		—		(23)		—		(23)
Changes in								
Accrued interest receivable		—		1		(40)		(39)
Accounts receivable		(252)		(16)		—		(268)
Loans receivable		—		—		(5,898)		(5,898)
Accounts payable		252		(248)		—		4
Deferred fees		—		377		—		377
		<u>—</u>		<u>377</u>		<u>—</u>		<u>377</u>
Net cash provided by operating activities	\$	<u>0</u>	\$	<u>464</u>	\$	<u>(5,543)</u>	\$	<u>(5,079)</u>