State of Arkansas Safe Drinking Water Revolving Loan Fund Program

Independent Auditor's Report and Financial Statements

June 30, 2017 and 2016

BKD LLP
CPAs & Advisors

State of Arkansas Safe Drinking Water Revolving Loan Fund Program

June 30, 2017 and 2016

Contents

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Independent Auditor's Report

The Commissioners of the Arkansas Natural
Resources Commission (ANRC)

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

Report on the Financial Statements

We have audited the accompanying financial statements of the State of Arkansas Safe Drinking Water Revolving Loan Fund Program (the Program), which are comprised of statements of net position as of June 30, 2017 and 2016, and the related statements of revenues, expenses and changes in net position and statements of cash flows for the years ended June 30, 2017 and 2016, and the related notes to the financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our 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 audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

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, 2017 and 2016, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of a Matter

As discussed in *Note 1*, the financial statements present only the Program and do not purport to, and do not, present fairly the financial position of the State of Arkansas as of June 30, 2017 and 2016, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis listed in the table of contents be presented to supplement the basic financial statements. Such information, although not 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.

Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The supplementary information listed in the table of contents, is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards,* we have also issued our report dated October 31, 2017, 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 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 the 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 Program's internal control over financial reporting and compliance.

BKD, LLP

Little Rock, Arkansas
October 31, 2017

State of Arkansas Safe Drinking Water Revolving Loan Fund Program

Management's Discussion and Analysis

June 30, 2017 and 2016

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 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, 2017, basic financial statements include three required statements: the statement of net position; the statement of revenues, expenses and changes in net position; and the statement of cash flows. Comparative totals as of and for the years ended June 30, 2016 and 2015, 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 position; the combining statement of revenues, expenses and changes in net position; as well as the combining statement of cash flows. These combining statements detail the Revolving Loan Fund, the Fees and Expense Set Aside, the Small System Technical Assistance Set Aside, the Well Head Protection Set Aside, the Capacity Development Set Aside and the State Program Management Set Aside, which comprise the Program.

Condensed Financial Information – Statements of Net Position

(In thousands)

	2017	2016	2015
Total assets	$ 262,285	$ 254,246	$ 247,780
Current liabilities	2,560	2,429	2,431
Noncurrent liabilities	19,065	21,184	23,380
Total liabilities	21,625	23,613	25,811
Net position – restricted by bond resolution and program requirements	$ 240,660	$ 230,633	$ 221,969

The Program's total assets have continually increased over the past three years. At June 30, 2017, total assets increased $8.0 million from June 30, 2016, which was primarily attributable to an increase of $25.6 million in cash and cash equivalents, which is offset by a decrease of $17.9 million in total investments and loans receivable – restricted. At June 30, 2016, total assets increased $6.5 million from June 30, 2015, which was primarily attributed to the $12.7 million increase in investments, which is offset by decreases totaling $6.3 million in cash and cash equivalents, loan receivable – restricted and account receivable – Environmental Protection Agency (EPA).

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

	2017	2016	2015
Loan disbursements	$ 5,514	$ 6,407	$ 12,083
Loan repayments	14,311	8,142	7,989
Net (decrease) increase in loans receivable	$ (8,797)	$ (1,735)	$ 4,094

Grants from the EPA comprised 100%, 53% and 80% of the funding source of the repayable loan disbursements for fiscal years ended June 30, 2017, 2016 and 2015, respectively. The table below reflects the amounts used from each funding source for fiscal years 2017, 2016 and 2015 as follows (in thousands):

	2017	2016	2015
EPA Federal			
Base	$ 5,514	$ 3,374	$ 9,609
Revolving Loan Funds	-	111	-
State Matching	-	2,922	2,474
	$ 5,514	$ 6,407	$ 12,083

The Program utilized EPA federal grants to fund loans. A decline in loan activity has slowed the disbursement of funds, but the Program anticipates loan construction to increase. The Program has other funding sources available including $2.6 million of the Federal fiscal year 2016 state match, $3.4 million of the Federal fiscal year 2015 federal grant and $6.5 million of the Federal fiscal year 2016 federal grant and revolving Program funds to meet the anticipated loan demands.

The Program's loan repayments have increased over the past three years, which consists of the scheduled loan repayments and loan prepayments. The amount of loan prepayments totaled $5.9 million in fiscal year 2017 and none for fiscal year 2016. The Program's bond general resolution allows the Program to use loan prepayments to make new loans within 90 days of receipt, pay principal and interest at debt service or pay principal and interest on called bonds. The Program has used prepayment funds to pay scheduled debt service payments.

The Program maintains liquidity for funding loans. The Program invested excess funds in money market mutual funds, in U.S. agencies obligations and in the State Treasurer Money Management Trust Fund (MMTF) from time to time to allow for re-evaluation of the Program's liquidity needs. The MMTF has a rate of return higher than a money market mutual fund and the funds are available within one business days' notice. The money market mutual funds rates have gradually increased over the past three years. With the slight increase in interest rates along with the increased cash balances, the Program has structured its investment portfolio with maturities of every six months. Currently, the Program has $24.0 million in investments which will mature in the fiscal year 2018.

The Program's total liabilities decreased to $21.6 million at June 30, 2017, $23.6 million at June 30, 2016 and from $25.8 million at June 30, 2015. In fiscal year 2017 and 2016, the Program had a decline of $2.2 million each year in the bonds payable due to the payment of scheduled bond redemptions.

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

(In thousands)

	2017	2016	2015
Total interest income	$ 4,058	$ 3,702	$ 3,594
Other income	1,150	1,802	1,691
Total operating income	5,208	5,504	5,285
Program administration	178	184	183
Federal financial assistance	2,620	4,356	1,509
Total interest on bonds	984	1,074	1,139
Total amortization expense	(354)	(386)	(410)
Total operating expenses	3,428	5,228	2,421
Operating income	1,780	276	2,864
Federal grants	12,360	12,399	15,967
Transfers out, net	(4,113)	(4,011)	(4,573)
Change in net position	10,027	8,664	14,258
Net position			
Beginning of year	230,633	221,969	207,711
End of year	$ 240,600	$ 230,633	$ 221,969

Included in total interest income is interest earned on loans and interest earned on investments, which has increased to $4.1 million for the year ended June 30, 2017, from $3.7 million for the year ended June 30, 2016 and from $3.6 million for the year ended June 30, 2015. The Program had an increase in interest on investments of $701,000 which relates to the increase in money market mutual fund interest rates, the investing of funds in the MMTF and structuring U. S. agency investment maturities to mature every six months. The Program considers the $8.0 million in MMTF as cash and cash equivalents. These funds yield a slightly higher rate of return than the Program's other money market mutual fund rates. The interest on loans has decreased by $345,000, which correlates to the decline in loan receivable – restricted. In the prior year, revenues from investments increased to $193,000 which relates to an increase in the money market mutual fund rates. The average yield on cash, cash equivalents and investments for fiscal year 2017 has increased to 0.71%; whereas the average yields for 2016 and 2015 were 0.26% and 0.09%, respectively.

Other income includes financing fee income, which is the 1% servicing fee paid by the borrowers, and the net appreciation (depreciation) of investments. In the current fiscal year, the Program had a decline in the financing fee income of $98,000, which correlates to the decline in loans receivable – restricted. The Program's net appreciation (depreciation) of investments decreased $554,000, which is a change in the market value of the Program's investment portfolio. In the prior year, the Program had an increase in other income totaling $111,000 which is primarily attributed to an increase in net appreciation (depreciation) of investments.

Total operating expenses have fluctuated over the past three years to $3.4 million for the year ended June 30, 2017, from $5.2 million for the year ended June 30, 2016, and from $2.4 million for the year ended June 30, 2015. The decline in fiscal year 2017 was primarily attributed to the decline in federal financial assistance of $1.7 million. In the prior year, the increase of $2.8 million is attributable to increase in federal financial assistance. In fiscal year 2012, the Program began funding principal forgiveness loans from the Base capitalization grant as required by EPA. Each construction draw is forgiven at the time of the draw. The Program is required by state law to use only federal grant funds to make principal forgiveness loans. For the years ended June 30, 2017 and 2016, the Program has awarded principal forgiveness loans to multiple borrowers and has forgiven $2.6 million and $4.4 million, respectively.

For fiscal year 2017, the Program has had a slight decline of $39,000 in base federal grant revenue. The Program had an increase of $403,000 in base federal grant revenue for construction draws, which is offset by a decline of base federal grant revenue of $441,000 for administration expenses for Arkansas Natural Resources Commission (ANRC) and Arkansas Department of Health (DOH). For fiscal year 2016, federal grants declined $3.6 million which correlated with the decline in loan disbursements. The Program primarily used federal grants for funding loans and paying expenses. These funds were drawn down from the federal government as expenses were incurred by the municipalities, ANRC or DOH.

For the fiscal years 2017 and 2016, the Program's transfers out, net were $4.1 million and $4.0 million, respectively. As funds are available, the Program receives transfers in from the ANRC Water, Waste Disposal and Pollution Abatement Facilities General Obligation Bond Fund Program, which represents the state matching funds for the Program. Transfers out are transfers to state agencies for Program administration expenses. The details of transfers in and out are presented in the following table (in thousands):

	2017	2016	2015
ANRC-state match	$ -	$ 672	$ 479
Department of Health	(3,693)	(4,173)	(4,372)
ANRC-administration	(420)	(510)	(680)
Transfers out, net	$ (4,113)	$ (4,011)	$ (4,573)

The net position of the Program increased $18.7 million in the past two years. The bond resolutions and the Program restrict all of the net position.

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

Contact Regarding the Program

This financial report is designed to provide 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 Safe Drinking Water Revolving Loan Fund Program

Statements of Net Position

June 30, 2017 and 2016

(in thousands)	2017	2016
Current Assets		
Cash and cash equivalents	$ 41,597	$ 15,988
Accrued interest receivable		
Investment	186	107
Loans	195	203
Accounts Receivable		
Borrowers	108	112
Environmental Protection Agency	724	432
Investments - current portion	23,989	30,030
Total current assets	66,799	46,872
Noncurrent assets		
Investments - restricted	34,131	37,222
Loans receivable - restricted		
Construction	157,661	166,361
Northeast Arkansas Public Water Authority	3,694	3,791
Total noncurrent assets	195,486	207,374
Total assets	262,285	254,246
Current Liabilities		
Accounts payable	720	536
Accrued interest payable	75	83
Bonds payable - current portion	1,765	1,810
Total current liabilities	2,560	2,429
Noncurrent Liabilities		
Bonds payable, net of unamortized premiums	19,065	21,184
Total liabilities	21,625	23,613
Net Position		
Restricted by bond resolution and program administration	$ 240,660	$ 230,633

State of Arkansas Safe Drinking Water Revolving Loan Fund Program

Statements of Revenues, Expenses and Changes in Net Position

Years Ended June 30, 2017 and 2016

(in thousands)	2017	2016
Operating Revenues		
Interest on investments	$ 894	$ 193
Interest on loans	3,164	3,509
Financing fees	1,634	1,732
Net (deprecation) appreciation of investments	(484)	70
Total operating revenues	5,208	5,504
Operating Expenses		
Program administration	178	184
Federal financial assistance		
Base federal grants	2,620	4,356
Bond interest	984	1,074
Amortization of bond premiums	(354)	(386)
Total operating expenses	3,428	5,228
Operating Income	1,780	276
Nonoperating Revenue		
Base federal grants	12,360	12,399
Income Before Transfers Out, Net	14,140	12,675
Transfers Out, Net	(4,113)	(4,011)
Change in Net Position	10,027	8,664
Net Position, Beginning of year	230,633	221,969
Net Position, End of year	$ 240,660	$ 230,633

State of Arkansas Safe Drinking Water Revolving Loan Fund Program

Statements of Cash Flows

Years Ended June 30, 2017 and 2016

(in thousands)	2017	2016
Operating Activities		
Financing fees received	$ 1,640	$ 1,735
Cash paid for program administration	(182)	(185)
Net cash provided by operating activities	1,458	1,550
Noncapital Financing Activities		
Repayment of long-term debt	(1,810)	(1,805)
Cash paid for interest	(991)	(1,081)
Transfers out	(3,926)	(4,011)
Nonoperating grants received	12,068	12,825
Net cash provided by noncapital financing activities	5,341	5,928
Investing Activities		
Interest received on investments	816	130
Interest received on loans	3,170	3,519
Principal repayments on loans	14,311	8,142
Loan disbursements	(5,514)	(6,407)
Federal grant funds expended	(2,620)	(4,356)
Proceeds from maturities of investments	31,002	76,500
Purchase of investments	(22,355)	(89,177)
Net cash provided by (used in) investing activities	18,810	(11,649)
Increase (Decrease) in Cash and Cash Equivalents	25,609	(4,171)
Cash and Cash Equivalents, Beginning of year	15,988	20,159
Cash and Cash Equivalents, End of year	$ 41,597	$ 15,988

State of Arkansas Safe Drinking Water
Revolving Loan Fund Program
Statements of Cash Flows (Continued)
Years Ended June 30, 2017 and 2016

(in thousands)	2017	2016
Reconciliation of Operating Income to Net Cash Provided by Operating Activities		
Operating income	$ 1,780	$ 276
Items not requiring (providing) operating activities cash flows		
Interest on investments	(894)	(193)
Interest on loans	(3,164)	(3,509)
Bond interest	984	1,074
Amortization of bond premiums	(354)	(386)
Net depreciation (appreciation) of investments	484	(70)
Federal grants expended	2,620	4,356
Changes in		
Account receivable - borrowers	4	2
Accounts payable	(2)	-
Net cash provided by operating activities	$ 1,458	$ 1,550

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

Nature of Operations and Reporting Entity

Act 772 of 1997, as amended, (the Act) authorized the establishment of a fund known as the Safe Drinking Water Fund (the Program), an enterprise fund of the State of Arkansas, to be maintained and administrated by the Arkansas Natural Resources Commission (the Commission or ANRC), formerly known as Arkansas Soil and Water Conservation Commission, and the Arkansas Department of Health. Act 1243 of 2006 authorized the name change to ANRC, which has not had an impact on the Program. The Program is to be capitalized with federal grants, state matching grants, other grants, proceeds of bonds issued by the Arkansas Development Finance Authority (ADFA) or the Commission for the Program and loan repayments utilized 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.

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, 2017 and 2016, were $131,000 and $138,000, respectively.

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.

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 position. 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.

Recently Issued Accounting Pronouncements

GASB Statement No. 85, *Omnibus 2017*: This statement addresses practice issues that have been identified during implementation and application of certain GASB standards and addresses a variety of topics, including issues related to blending component units, goodwill, fair value measurement and postemployment benefits. The requirements of this statement are effective for reporting periods beginning after June 15, 2017. The Program has not yet determined the potential impact, if any, that this statement could have on its financial statements.

GASB Statement No. 86 – *Certain Debt Extinguishment Issues*: This statement improves consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources – resources other than the proceeds of refunding debt – are place in an irrevocable trust for the sole purpose of extinguishing debt. This statement is effective for periods beginning after June 15, 2017, with earlier application encouraged. The Program has not yet determined the potential impact, if any, that this statement could have on its financial statements.

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, 2017 and 2016, cash equivalents of approximately $41.6 million and $16.0 million, respectively, consisted of money market mutual funds with variable interest rates and an internal governmental investment pool administrated by the State of Arkansas. The maturity of the funds is considered to be less than one year because they are redeemable in full immediately.

Investments

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

Bond Premiums

Premiums on the sale 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 the premiums.

Net Position Restricted by Bond Resolution and Program Requirements

Net position restricted by bond resolution and 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.

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.

At June 30, 2017 and 2016, none of the Program's deposits were exposed to custodial credit risk.

Investments

Arkansas statutes authorize 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, 2017 and 2016, the Program had the following investments and maturities:

(In thousands)

	June 30, 2017				
		Maturities in Years			
Type	**Fair Value**	**Less than 1**	**1–5**	**6–10**	**More than 10**
U.S. agencies obligations	$ 58,120	$ 23,989	$ 34,131	$ -	$ -
Money market mutual funds	33,570	33,570	-	-	-
State Treasurer Money Management Trust Fund	8,027	8,027	-	-	-
	$ 99,717	$ 65,586	$ 34,131	$ -	$ -

(In thousands)

	June 30, 2016				
		Maturities in Years			
Type	**Fair Value**	**Less than 1**	**1–5**	**6–10**	**More than 10**
U. S. agencies obligations	$ 67,252	$ 30,030	$ 37,222	$ -	$ -
Money market mutual funds	15,988	15,988	-	-	-
Total	$ 83,240	$ 46,018	$ 37,222	$ -	$ -

Interest Rate Risk—As a means of limiting its exposure to fair value losses due to rising interest rates, the Program limits the maturity of investments to expected cash flow needs of the Program. The Program has also begun investing in an internal governmental investment pool administrated by the State of Arkansas which has a weighted average maturity of 25 days. The Program may request withdrawal of its funds with one business days' notice.

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" or not rated by Moody's Investment Service, and rated "AA+" or not rated by Standard & Poor's and its investments in money market mutual funds, or the investments of those funds were rated "AAA-f" or "AAA" by Standard & Poor's and "Aaa-mf" or "Aaa" by Moody's Investors Service.

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 Home Loan Bank	$	27,004	27%
Federal Home Loan Mortgage Corporation		26,121	26%

Summary of Carrying Values

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

(In thousands)		2017		2016
Carrying value				
Investments	$	99,717	$	83,240
Included in the following statement of net position captions				
Cash and cash equivalents	$	41,597	$	15,988
Investments - current portion		23,989		30,030
investments - restricted		34,131		37,222
	$	99,717	$	83,240

Note 3: Loans Receivable

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, 2017 and 2016, such loans had a carrying value of approximately $161.4 million and $170.2 million, respectively. The loans bear interest at 0.0% to 2.90% and are collateralized by special assessments, user charges or sales and use tax bonds issued by the municipalities.

In fiscal year 2010, the Program began funding loans with American Recovery and Reinvestment Act (ARRA) federal funds, along with other funding sources. As of June 30, 2017 and 2016, the Program's outstanding loan balance for ARRA loans totaled $20.0 million and $21.0 million, respectively.

Through the years ended June 30, 2017 and 2016, approximately $234.3 million and $228.6 million in loans, respectively, had cumulatively been approved for funding. At June 30, 2017 and 2016, approximately $9.1 million and $8.2 million, respectively, remained encumbered and awaiting disbursement to loan recipients.

Note 4: Bonds Payable

Bonds payable were as follows at June 30:

(in thousands)

Series	Interest Rate Range	Final Maturity Dates	2017	2016
2011-C				
Serial	3.25% - 5.00%	6/1/2028	$ 19,185	$ 20,995
	Unamortized premiums		1,645	1,999
			$ 20,830	$ 22,994

Activity in bonds payable for 2017 was as follows:

(in thousands)	Beginning Balance	Additions	Reductions	Ending Balance	Amount Due within One Year
2011-C	$ 20,995	$ -	$ (1,810)	$ 19,185	$ 1,765

The principal amount shown above differs from the amount on the statement of net position due to unamortized premiums of approximately $1.6 million.

Activity in bonds payable for 2016 was as follows:

(In thousands)	Beginning Balance	Additions	Reductions	Ending Balance	Amount Due within One Year
2011-C	$ 22,800	$ -	$ (1,805)	$ 20,995	$ 1,810

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

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

(in thousands)	Principal	Interest
Fiscal Year Ending June 30,		
2018	$ 1,765	$ 901
2019	2,205	812
2020	2,065	702
2021	1,985	599
2022	1,900	500
2023-2027	8,515	1,111
2028	750	26
	19,185	4,651
Unamortized premiums	1,645	-
	$ 20,830	$ 4,651

The Program did not have any new bond issuances in the current or previous fiscal years.

Note 5: Disclosures About Fair Value of Assets and Liabilities

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs. There is a hierarchy of three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs supported by little or no market activity and are significant to the fair value of the assets or liabilities.

Recurring Measurements

The following table presents the fair value measurements of assets recognized in the accompanying financial statements measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at June 30, 2017 and 2016:

(in thousands)	June 30, 2017			
	Fair Value Measurements Using			
Type	**Fair Value**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
U. S. agency obligations	$ 58,120	$ -	$ 58,120	$ -
State Treasurer Money Management Trust Fund	8,027	-	8,027	-
Total	$ 66,147	$ -	$ 66,147	$ -

(in thousands)	June 30, 2016			
	Fair Value Measurements Using			
Type	**Fair Value**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
U. S. agencies obligations	$ 67,252	$ -	$ 67,252	$ -

Following is a description of the valuation methodologies and inputs used for assets measured at fair value on a recurring basis and recognized in the accompanying financial statements, as well as the general classification of such assets pursuant to the valuation hierarchy. There have been no significant changes in the valuation techniques during the years ended June 30, 2017 or 2016.

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. The Program did not classify any of its investments as Level 1 at June 30, 2017 or June 30, 2016. Level 2 securities include U.S. Government and federal agencies and the State Treasurer Money Management Trust Fund (MMTF). If quoted market prices are not available, then fair values are estimated by an independent third-party pricing service using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. For these investments, the inputs used by the pricing service to determine fair value may include one, or a combination of observable inputs such as benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data market research publications. The fair value of MMTF is calculated by the internal governmental investment pool. All these types of the Program's investments are classified within Level 2 of the valuation hierarchy. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy. The Program did not have any Level 3 securities at June 30, 2017 or June 30, 2016.

The fair value amounts in the previous table do not reflect all investments included in the amounts presented in the statement of financial position. GASB 72 provides certain exceptions for money market mutual funds.

Note 6: 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 (EPA). During 2017 and 2016, the Program received approximately 70% and 69%, respectively, of total revenue in the form of federal grants.

Program Set Asides

As shown in the supplemental information, the Program has five set aside funds. These set aside funds make up 31% of the annual capitalization grant awarded each year. These funds are used to provide for reimbursement of expenses of the Program. Through federal regulations, the EPA has allowed states to redirect and reserve set asides as needed to ensure proper management of funds.

Section 1452 of the EPA Federal Guidelines for the Implementation of Drinking Water State Revolving Loan Fund (DWSRF) indicates a state may reserve the right to redirect unused set aside funds as eligible expenditures of the Program. Since the inception of the Program, ANRC, in conjunction with DOH, has redirected approximately $6.3 million from previous years' capitalization grants as eligible funds for disbursement to loan borrowers, with the caveat that those redirected funds may be reclaimed as set aside funds in future federal grants. The Program has reclaimed $798,000 of the funds previously redirected. Only the State Program Management and Small System Technical Assistance set asides may be reclaimed in future grant years. All other set aside are not eligible to be reclaimed.

The Code of Federal Regulations section 40 CFR 3540, regarding the DWSRF, states a state may reserve or "bank" set aside funds at the time of the grant application. The intent is that the authority for a set aside activity from one year can be used in a future year when the amount available in that future year is not enough to accomplish the set aside activity. Each set aside activity has specific eligible costs associated with it. Reserved authority in a set aside activity can only be used for that same set aside activity in the future. For each grant application, the state has to demonstrate to EPA that the funds requested for each set aside activity can be used within a two year period. If this results in the state having additional authority for that activity that they cannot use within the two year period, they can reserve that additional authority for some unspecified future grant. The amount of authority reserved for each set aside activity will be reported in the Intended Use Plan (IUP) for that fiscal year and every succeeding IUP until the authority is used. When the state wants to use the authority that has been reserved, the state must demonstrate to EPA that all of the authority in the future grant and the additional reserved authority can be expended within the two year period. The management of the Program is aware if future federal capitalization grants are not made available, the reserved authority is lost. Since the inception of the Program, DOH has reserved authority of $9.4 million in the Small System Technical Assistance and the State Program Management Set Asides with the caveat that those redirected funds may be reclaimed as set aside funds in future federal grants. The Program has reclaimed $1.3 million of these set aside funds.

Principal Forgiveness Loans

In fiscal year 2012, the Program began funding principal forgiveness loans (PF) with Base federal grant funds. EPA required as part of the Base capitalization grant requirements that a percentage of the grant be available as subsidy to eligible borrowers. With the federal fiscal year 2010 and 2011 capitalization grant, at least 30% of the grant would be in the form of forgiveness of principal, negative interest loans or grants. The percentage was changed to be not less than 20%, but not greater than 30% of the federal fiscal year 2012 through 2016 grants. To be eligible to receive subsidy, the borrower must show either:

1. The current utility rates or proposed utility rates for 4,000 gallons of water on an annual basis are at least 1.5% of the Median Household Income (MHI) for the project area.

2. The customers who benefit from a project are at least 51% have either Low or Moderate Income as defined by the U. S. Department of Housing and Urban Developments' Community Block Grant Program; and have 1.25% of MHI.

The chart below shows the minimum and maximum allowed for principal forgiveness loans:

(In thousands)

Federal Fiscal Year	Base Capitalization Grant Award	PF Minimum Amount	PF Maximum Amount	Program Allocation Amount	Cumulative Disbursements	PF Remaining to Disburse
2010	$ 20,539	$ 6,162	$ 20,539	$ 6,163	$ 6,163	$ -
2011	14,252	4,276	14,252	4,278	4,278	-
2012	13,582	2,716	4,075	2,743	2,716	27
2013	12,743	2,549	3,823	2,555	2,555	-
2014	13,534	2,707	4,660	2,707	2,543	164
2015	13,445	2,689	4,033	2,689	611	2,078
2016	12,719	2,544	3,816	2,544	-	2,544
Totals					$ 18,866	$ 4,813

The Program has targeted the minimum amount from each Base Capitalization grant for principal forgiveness loans. The Program forgives the loans as the construction draws are disbursed. In fiscal year 2017 and 2016, the Program expensed $2.6 million and $4.4 million in principal forgiveness loans, respectively.

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 collectability of any related receivable at June 30, 2017 and 2016, 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 Safe Drinking Water Revolving Loan Fund Program

Combining Statement of Net Position

June 30, 2017

(in thousands)	Small System Technical Assistance	Well Head Protection	Capacity Development	State Program Management
Current Assets				
Cash and cash equivalents	$ -	$ -	$ -	$ -
Accrued interest receivable				
Investment	-	-	-	-
Loans	-	-	-	-
Accounts Receivable				
Borrowers	-	-	-	-
Environmental Protection Agency	34	60	109	380
Investments - current portion	-	-	-	-
Total current assets	34	60	109	380
Noncurrent assets				
Investments - restricted	-	-	-	-
Loans receivable - restricted				
Construction	-	-	-	-
Northeast Arkansas Public Water Authority	-	-	-	-
Total noncurrent assets	-	-	-	-
Total assets	34	60	109	380
Current Liabilities				
Accounts payable	34	60	109	380
Accrued interest payable	-	-	-	-
Bonds payable - current portion	-	-	-	-
Total current liabilities	34	60	109	380
Noncurrent Liabilities				
Bonds payable, net of unamortized premiums	-	-	-	-
Total liabilities	34	60	109	380
Net Position				
Restricted by bond resolution and program administration	$ -	$ -	$ -	$ -

Fees and Expense	Revolving Loan Fund	Total
$ 4,697	$ 36,900	$ 41,597
1	185	186
3	192	195
108	-	108
141	-	724
-	23,989	23,989
4,950	61,266	66,799
-	34,131	34,131
-	157,661	157,661
3,694	-	3,694
3,694	191,792	195,486
8,644	253,058	262,285
131	6	720
-	75	75
-	1,765	1,765
131	1,846	2,560
-	19,065	19,065
131	20,911	21,625
$ 8,513	$ 232,147	$ 240,660

State of Arkansas Safe Drinking Water
Revolving Loan Fund Program

Combining Statement of Revenues, Expenses and Changes in Net Position

Year Ended June 30, 2017

(in thousands)	Small System Technical Assistance	Well Head Protection	Capacity Development	State Program Management
Operating Revenues				
Interest on investments	$ -	$ -	$ -	$ -
Interest on loans	-	-	-	-
Financing fees	-	-	-	-
Net deprecation of investments	-	-	-	-
Total operating revenues	-	-	-	-
Operating expenses				
Program administration	-	-	-	-
Federal financial assistance				
Base federal grants	-	-	-	-
Bond interest	-	-	-	-
Amortization of bond premiums	-	-	-	-
Total operating expenses	-	-	-	-
Operating Income	-	-	-	-
Nonoperating Revenue				
Base federal grants	243	749	1,343	1,358
Income Before Transfers (Out) In, Net	243	749	1,343	1,358
Transfers (Out) In, Net	(243)	(749)	(1,343)	(1,358)
Change in Net Position	-	-	-	-
Net Position, Beginning of year	-	-	-	-
Net Position, End of year	$ -	$ -	$ -	$ -

Fees and Expense	Revolving Loan Fund	Total
$ 29	$ 865	$ 894
75	3,089	3,164
1,634	-	1,634
(2)	(482)	(484)
1,736	3,472	5,208
178	-	178
-	2,620	2,620
-	984	984
-	(354)	(354)
178	3,250	3,428
1,558	222	1,780
533	8,134	12,360
2,091	8,356	14,140
(2,968)	2,548	(4,113)
(877)	10,904	10,027
9,390	221,243	230,633
$ 8,513	$ 232,147	$ 240,660

State of Arkansas Safe Drinking Water Revolving Loan Fund Program

Combining Statement of Cash Flows

Year Ended June 30, 2017

(in thousands)	Small System Technical Assistance	Well Head Protection	Capacity Development	State Program Management
Operating Activities				
Financing fees received	$ -	$ -	$ -	$ -
Cash paid for program administration	-	-	-	-
Net cash provided by operating activities	-	-	-	-
Noncapital Financing Activities				
Repayment of long-term debt	-	-	-	-
Cash paid for interest	-	-	-	-
Transfers (out), in	(209)	(792)	(1,411)	(1,094)
Nonoperating grants received	209	792	1,411	1,094
Net cash (used in) provided by noncapital financing activities	-	-	-	-
Investing Activities				
Interest received on investments	-	-	-	-
Interest received on loans	-	-	-	-
Principal repayments on loans	-	-	-	-
Loan disbursements	-	-	-	-
Federal grant funds expended	-	-	-	-
Proceeds from maturities of investments	-	-	-	-
Purchase of investments	-	-	-	-
Net cash provided by investing activities	-	-	-	-
Increase in Cash and Cash Equivalents	-	-	-	-
Cash and Cash Equivalents, Beginning of year	-	-	-	-
Cash and Cash Equivalents, End of year	$ -	$ -	$ -	$ -
Reconciliation of Operating Income to Net Cash Provided by Operating Activities				
Operating income	$ -	$ -	$ -	$ -
Items not requiring (providing) operating activities cash flows				
Interest on investments	-	-	-	-
Interest on loans	-	-	-	-
Bond interest	-	-	-	-
Amortization of bond premiums	-	-	-	-
Net depreciation of investments	-	-	-	-
Federal grants expended	-	-	-	-
Changes in				
Account receivable - borrowers	-	-	-	-
Accounts payable	-	-	-	-
Net cash provided by operating activities	$ -	$ -	$ -	$ -

Fees and Expense	Revolving Loan Fund	Total
$ 1,640	$ -	$ 1,640
(186)	4	(182)
1,454	4	1,458
-	(1,810)	(1,810)
-	(991)	(991)
(2,968)	2,548	(3,926)
428	8,134	12,068
(2,540)	7,881	5,341
38	778	816
75	3,095	3,170
96	14,215	14,311
-	(5,514)	(5,514)
-	(2,620)	(2,620)
3,001	28,001	31,002
-	(22,355)	(22,355)
3,210	15,600	18,810
2,124	23,485	25,609
2,573	13,415	15,988
$ 4,697	$ 36,900	$ 41,597
$ 1,558	$ 222	$ 1,780
(29)	(865)	(894)
(75)	(3,089)	(3,164)
-	984	984
-	(354)	(354)
2	482	484
-	2,620	2,620
4	-	4
(6)	4	(2)
$ 1,454	$ 4	$ 1,458