

State of Arkansas Safe Drinking Water Revolving Loan Fund Program

Accountants' Report and Financial Statements

June 30, 2004 and 2003



**State of Arkansas Safe Drinking Water Revolving Loan
Fund Program
June 30, 2004 and 2003**

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State of Arkansas Safe Drinking Water Revolving Loan Fund Program 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 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, 2003, 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 year. Additional information, following the Notes to the 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, the Fees and Expense Fund, 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 – Statement of Net Assets

(In thousands)

	2004	2003
Total assets	\$ <u>34,026</u>	\$ <u>23,459</u>
Current liabilities	148	1,415
Noncurrent liabilities	<u>1,330</u>	<u>906</u>
Total liabilities	<u>1,478</u>	<u>2,321</u>
Total net assets – restricted by program administration	\$ <u><u>32,548</u></u>	\$ <u><u>21,138</u></u>

The Program's total assets increased 45.0% to \$34.0 million at June 30, 2004, compared to \$23.5 million at June 30, 2003. The increase is primarily attributed to the funding of \$2.91 million of the \$16.1 million in new loans approved during the year as well as disbursements of \$9.31 million related to existing loans. The Program issued four new loans for fiscal year 2004 to the City of Texarkana, the City of Arkadelphia, the City of Malvern and the City of Manila. The construction period for the loans of the Program is approximately two years.

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

The Program's total liabilities decreased 36.3% to \$1.5 million at June 30, 2004, from \$2.3 million at June 30, 2003. The decrease is primarily attributed to the accrual for the program administration expenses payable to the Department of Health of \$120 thousand at June 30, 2004 compared to the payable of \$1.4 million at June 30, 2003. The deferred fee balance increased \$424 thousand to \$1.33 million in fiscal year 2004. The balance increase is attributable to the three percent (3%) loan-closing fee received by the Program that is amortized over the life of the loan.

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

	2004	2003
Total investment income	\$ 584	\$ 399
Other income	<u>249</u>	<u>410</u>
Total operating revenues	833	809
Administrative expenses	<u>49</u>	<u>41</u>
Operating income	784	768
Transfer out	(2,141)	(2,984)
Federal grants	<u>12,767</u>	<u>9,175</u>
Change in net assets	11,410	6,959
Net assets		
Beginning of year	<u>21,138</u>	<u>14,179</u>
End of year	<u>\$ 32,548</u>	<u>\$ 21,138</u>

The change in net assets of \$11.4 million for the year ending June 30, 2004, increased \$4.5 million compared to fiscal year 2003. This is attributable to the increase in the amount of federal grants received during the year. The grants are primarily used by the Program for funding loans and expenses, and the increase relates to the increase in loans receivable.

Included in the total investment income is interest received on loans, which increased 61.6% to \$538 thousand in fiscal year 2004, from \$333 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 \$20 thousand, with the average return on cash and cash equivalents of 0.78% in 2004 compared to 1.2% in 2003.

The overall financial position and results of operations of the Program have 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 statements of net assets of the State of Arkansas Safe Drinking Water Revolving Loan Fund Program (the "Program") as of June 30, 2004 and 2003, and the related statements of revenues, expenses and changes in net assets and cash flows for the years 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 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 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, 2004 and 2003, 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, 2004 and 2003, 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 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 3, 2004, 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 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.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. 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 3, 2004

**State of Arkansas Safe Drinking Water Revolving Loan
Fund Program
Statements of Net Assets
June 30, 2004 and 2003**

	2004	2003
<i>In thousands</i>		
Current Assets		
Cash and cash equivalents	\$ 5,931	\$ 6,085
Accrued interest receivable	58	46
Accounts receivable		
Borrowers	23	16
Environmental Protection Agency	173	1,391
Total current assets	6,185	7,538
Noncurrent Assets		
Loans receivable – restricted	27,841	15,921
Total assets	34,026	23,459
Current Liabilities		
Accounts payable	148	1,415
Noncurrent Liabilities		
Deferred fees	1,330	906
Total liabilities	1,478	2,321
Net Assets		
Restricted for program requirements	\$ 32,548	\$ 21,138

State of Arkansas Safe Drinking Water Revolving Loan Fund Program

Statements of Revenues, Expenses and Changes in Net Assets Years Ended June 30, 2004 and 2003

In thousands

	2004	2003
Operating Revenues		
Interest on investments	\$ 46	\$ 66
Interest on loans	538	333
Financing fees	249	155
Other	—	255
Total operating revenues	833	809
Operating Expenses		
Program administration	49	41
Operating Income	784	768
Nonoperating Income		
Federal grants	12,767	9,175
Income Before Transfers Out	13,551	9,943
Transfers Out	(2,141)	(2,984)
Change in Net Assets	11,410	6,959
Net Assets, Beginning of Year	21,138	14,179
Net Assets, End of Year	\$ 32,548	\$ 21,138

**State of Arkansas Safe Drinking Water Revolving Loan
Fund Program
Statements of Cash Flows
Years Ended June 30, 2004 and 2003**

In thousands

	2004	2003
Operating Activities		
Interest received on loans and investments	\$ 572	\$ 360
Loan disbursements	(12,217)	(6,113)
Principal payments on loans	297	215
Financing fees	666	492
Cash paid for program administration	(45)	(33)
Net cash used in operating activities	(10,727)	(5,079)
Noncapital Financing Activities		
Transfers out	(3,412)	(2,732)
Nonoperating grants received	13,985	8,923
Net cash provided by noncapital financing activities	10,573	6,191
Increase (Decrease) in Cash and Cash Equivalents	(154)	1,112
Cash and Cash Equivalents, Beginning of Year	6,085	4,973
Cash and Cash Equivalents, End of Year	\$ 5,931	\$ 6,085
Reconciliation of Operating Income to Net Cash Used in Operating Activities		
Operating income	\$ 784	\$ 768
Item not providing operating activities cash flows		
Amortization	(33)	(23)
Changes in		
Accrued interest receivable	(12)	(39)
Accounts receivable	1,264	(268)
Loans receivable	(11,920)	(5,898)
Accounts payable	(1,267)	4
Deferred fees	457	377
Net cash used in operating activities	\$ (10,727)	\$ (5,079)

State of Arkansas Safe Drinking Water Revolving Loan Fund Program

Notes to Financial Statements
June 30, 2004 and 2003

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") to be maintained and administered by the Arkansas Soil and Water Conservation Commission (the "Commission" or "ASWCC") and the Arkansas Department of Health. 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 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.

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 auditing services. ADFA is reimbursed for Program administration costs through a calculation based on loans outstanding in accordance with an interagency agreement with ASWCC. The amount paid to ADFA for administration costs for the years ending June 30, 2004 and 2003 were \$28 thousand and \$24 thousand, 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.

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.

State of Arkansas Safe Drinking Water Revolving Loan Fund Program

Notes to Financial Statements June 30, 2004 and 2003

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, 2004 and 2003, cash equivalents of approximately \$5.9 million and \$6.1 million, respectively, consisted primarily of money market mutual funds with variable interest rates.

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, 2004 and 2003, such loans had a carrying value of approximately \$27.8 million and \$15.9 million, respectively. The loans bear interest at 2.25% 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, 2004 and June 30, 2003, approximately \$48.3 million and \$33.1 million, respectively, had cumulatively been approved for funding. At June 30, 2004 and June 30, 2003, approximately \$15.5 million and \$16.8 million, respectively, remained encumbered and awaiting disbursement to loan recipients.

Net Assets Restricted for 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: 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 2004 and 2003, the Program received approximately 94% and 92%, 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, 2004 and 2003, 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 Assets
June 30, 2004**

<i>In thousands</i>	Small System Technical Assistance (TA)	Well Head Protection (WHP)	Capacity Development (CD)	State Program Management (PWSS)
Current Assets				
Cash and cash equivalents	\$ —	\$ —	\$ —	\$ —
Accrued interest receivable	—	—	—	—
Accounts receivable - borrowers	—	—	—	—
Accounts receivable - EPA	<u>37</u>	<u>8</u>	<u>—</u>	<u>75</u>
Total current assets	37	8	0	75
Noncurrent Assets				
Loans receivable – restricted	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Total assets	<u>37</u>	<u>8</u>	<u>0</u>	<u>75</u>
Current Liabilities				
Accounts payable	37	8	—	75
Noncurrent Liabilities				
Deferred fees	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Total liabilities	<u>37</u>	<u>8</u>	<u>0</u>	<u>75</u>
Net Assets				
Restricted for program requirements	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>

Fees and Expenses	Revolving Loan Fund	Total
\$ 1,440 1	\$ 4,491 57	\$ 5,931 58
23	—	23
<u>53</u>	<u>—</u>	<u>173</u>
1,517	4,548	6,185
<u>—</u>	<u>27,841</u>	<u>27,841</u>
<u>1,517</u>	<u>32,389</u>	<u>34,026</u>
27	1	148
<u>1,330</u>	<u>—</u>	<u>1,330</u>
<u>1,357</u>	<u>1</u>	<u>1,478</u>
<u>\$ 160</u>	<u>\$ 32,388</u>	<u>\$ 32,548</u>

**Sate of Arkansas Safe Drinking Water Revolving Loan
Fund Program**
Combining Statement of Revenues, Expenses and Changes in Net Assets
Year Ended June 30, 2004

<i>In thousands</i>	Small System Technical Assistance (TA)	Well Head Protection (WHP)	Capacity Development (CD)	State Program Management (PWSS)
Operating Revenues				
Interest on investments	\$ —	\$ —	\$ —	\$ —
Interest on loans	—	—	—	—
Financing fees	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Total operating revenues	0	0	0	0
Operating Expenses				
Program administration	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Operating Income	0	0	0	0
Nonoperating Income				
Federal grants	<u>268</u>	<u>210</u>	<u>472</u>	<u>870</u>
Income Before Transfers Out	268	210	472	870
Transfers Out	<u>(268)</u>	<u>(210)</u>	<u>(472)</u>	<u>(873)</u>
Change in Net Assets	0	0	0	(3)
Net Assets, Beginning of Year	<u>—</u>	<u>—</u>	<u>—</u>	<u>3</u>
Net Assets, End of Year	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>

Fees and Expenses	Revolving Loan Fund	Total
\$ 7	\$ 39	\$ 46
—	538	538
<u>249</u>	<u>—</u>	<u>249</u>
256	577	833
<u>49</u>	<u>—</u>	<u>49</u>
207	577	784
<u>402</u>	<u>10,545</u>	<u>12,767</u>
609	11,122	13,551
<u>(322)</u>	<u>4</u>	<u>(2,141)</u>
287	11,126	11,410
<u>(127)</u>	<u>21,262</u>	<u>21,138</u>
<u>\$ 160</u>	<u>\$ 32,388</u>	<u>\$ 32,548</u>

**State of Arkansas Safe Drinking Water Revolving Loan
Fund Program
Combining Statement of Cash Flows
Year Ended June 30, 2004**

	Small System Technical Assistance (TA)	Well Head Protection (WHP)	Capacity Development (CD)	State Program Management (PWSS)
Operating Activities				
Interest received on loans and investments	\$ —	\$ —	\$ —	\$ —
Loan disbursements	—	—	—	—
Principal payments on loans	—	—	—	—
Financing fees	—	—	—	—
Cash paid for program administration	—	—	—	—
Net cash provided by (used in) operating activities	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Noncapital Financing Activities				
Transfers out	(356)	(522)	(576)	(1,640)
Nonoperating grants received	<u>356</u>	<u>522</u>	<u>576</u>	<u>1,637</u>
Net cash provided by (used in) noncapital financing activities	<u>0</u>	<u>0</u>	<u>0</u>	<u>(3)</u>
Increase (Decrease) in Cash and Cash Equivalents	0	0	0	(3)
Cash and Cash Equivalents, Beginning of Year	<u>—</u>	<u>—</u>	<u>—</u>	<u>3</u>
Cash and Cash Equivalents, End of Year	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>
Reconciliation of Operating Activities to Net Cash Provided By (Used In) Operating Activities				
Operating income	\$ —	\$ —	\$ —	\$ —
Items not requiring (providing) operating activities cash flows				
Depreciation and amortization	—	—	—	—
Changes in				
Accrued interest receivable	—	—	—	—
Accounts receivable				
Environmental Protection Agency	89	312	104	767
Borrowers	—	—	—	—
Loans receivable	—	—	—	—
Accounts payable	(89)	(312)	(104)	(767)
Deferred fees	—	—	—	—
Net cash provided by (used in) operating activities	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>

Fees and Expense	Revolving Loan Fund	Total
\$ 7	\$ 565	\$ 572
—	(12,217)	(12,217)
—	297	297
666	—	666
<u>(45)</u>	<u>—</u>	<u>(45)</u>
<u>628</u>	<u>(11,355)</u>	<u>(10,727)</u>
(322)	4	(3,412)
<u>349</u>	<u>10,545</u>	<u>13,985</u>
<u>27</u>	<u>10,549</u>	<u>10,573</u>
655	(806)	(154)
<u>785</u>	<u>5,297</u>	<u>6,085</u>
<u>\$ 1,440</u>	<u>\$ 4,491</u>	<u>\$ 5,931</u>
\$ 207	\$ 577	\$ 784
(33)	—	(33)
—	(12)	(12)
(1)	—	1,271
(7)	—	(7)
—	(11,920)	(11,920)
5	—	(1,267)
<u>457</u>	<u>—</u>	<u>457</u>
<u>\$ 628</u>	<u>\$ (11,355)</u>	<u>\$ (10,727)</u>