Arkansas Development Finance Authority,

a Component Unit of the State of Arkansas

Combined Financial Statements, Required Supplementary Information, and Additional Information for the Year Ended June 30, 1999, and Independent Auditors' Report

ARKANSAS DEVELOPMENT FINANCE AUTHORITY,
A COMPONENT UNIT OF THE STATE OF ARKANSAS

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INDEPENDENT AUDITORS' REPORT

The Board of Directors of
Arkansas Development Finance Authority:

We have audited the accompanying combined balance sheet of Arkansas Development Finance Authority, a Component Unit of the State of Arkansas (the "Authority"), as of June 30, 1999, and the related combined statements of revenues, expenses, and changes in retained earnings and of cash flows for the year then ended. These combined financial statements are the responsibility of the management of the Authority. Our responsibility is to express an opinion on these combined financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards 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.

In our opinion, such combined financial statements present fairly, in all material respects, the financial position of the Authority as of June 30, 1999, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

Also, as more fully discussed in Note 9, the Authority has restated retained earnings as of June 30, 1998, to more appropriately reflect the relationship of certain related entities in accordance with the provisions of GASB Statement No. 14, *The Financial Reporting Entity*.

The year 2000 supplementary information on pages 16-17 is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board, and we did not audit and do not express an opinion on such information. Further, we were unable to apply to the information certain procedures prescribed by professional standards because of the unprecedented nature of the year 2000 issue and its effects, and the fact that authoritative measurement criteria regarding the status of remediation efforts have not been established. In addition, we do not provide assurance that the Authority is or will become year 2000 compliant, that the Authority's year 2000 remediation efforts will be successful in whole or in part, or that parties with which the Authority does business are or will become year 2000 compliant.

Our audit was conducted for the purpose of forming an opinion on the combined financial statements taken as a whole. The combining financial statements listed in the foregoing table of contents are presented for the purpose of additional analysis and are not a required part of the financial statements of the Authority. These financial statements are also the responsibility of the management of the Authority. Such additional information has been subjected to the auditing procedures applied in our audit of the combined financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the combined financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 5, 1999, on our consideration of the Authority's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants.

Deloitte & Touche LLP

Little Rock, Arkansas
November 5, 1999

ARKANSAS DEVELOPMENT FINANCE AUTHORITY,
A COMPONENT UNIT OF THE STATE OF ARKANSAS

COMBINED BALANCE SHEET
JUNE 30, 1999
(EXPRESSED IN THOUSANDS)

ASSETS	
Cash and cash equivalents (Note 2)	$ 155,841
Accounts receivable	2,797
Accrued interest receivable	8,749
Accrued rent receivable	906
Investments, at fair value (Note 2)	887,890
Loans receivable, net (Notes 3, 6, and 8)	409,203
Deferred charges	16,142
Direct financing leases (Note 4)	73,945
Real estate owned	1,368
Capitalized assets, net	475
TOTAL ASSETS	$1,557,316
LIABILITIES AND RETAINED EARNINGS	
Accounts payable	$ 2,576
Accrued interest payable	26,405
Bonds and notes payable, net of unamortized discounts and premiums (Note 5)	1,376,337
Deferred fees, advances, grants, and credits	30,218
Total liabilities	1,435,536
COMMITMENTS AND CONTINGENCIES (Notes 3, 6, and 8)	
RETAINED EARNINGS (Note 9):	
Reserved for programs	81,307
Unreserved	40,473
Total retained earnings	121,780
TOTAL LIABILITIES AND RETAINED EARNINGS	$1,557,316

See notes to financial statements.

ARKANSAS DEVELOPMENT FINANCE AUTHORITY,
A COMPONENT UNIT OF THE STATE OF ARKANSAS

COMBINED STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN RETAINED EARNINGS
YEAR ENDED JUNE 30, 1999
(EXPRESSED IN THOUSANDS)

REVENUES:	
Investment income:	
Loans and direct financing lease income	$ 31,761
Interest and dividends	60,782
Amortization of discounts on loans	8,299
Financing fee income	4,864
Net depreciation in the fair value of investments	(24,508)
Total investment income	81,198
Federal financial assistance (Note 8)	17,182
Other income	291
Total revenues	98,671
EXPENSES:	
Interest on bonds and notes:	
Current interest	83,564
Accreted interest	1,722
Total interest on bonds and notes	85,286
Amortization:	
Amortization of discounts and premiums on bonds and notes	1,329
Amortization of bond and note issuance costs	4,191
Total amortization	5,520
Administrative expenses:	
Provision for loan losses	380
Federal financial assistance programs	11,257
Salaries and benefits (Note 7)	2,885
Operations and maintenance	552
Other	3,726
Total administrative expenses	18,800
Total expenses	109,606
NET LOSS	(10,935)
RETAINED EARNINGS:	
Beginning of year, as adjusted (Note 9)	132,715
End of year	$ 121,780

See notes to financial statements.

ARKANSAS DEVELOPMENT FINANCE AUTHORITY,
A COMPONENT UNIT OF THE STATE OF ARKANSAS

COMBINED STATEMENT OF CASH FLOWS
YEAR ENDED JUNE 30, 1999
(EXPRESSED IN THOUSANDS)

OPERATING ACTIVITIES:	
Net loss	$ (10,935)
Adjustments to reconcile net loss	
to net cash used by operating activities:	
Amortization of discounts on loans	(8,299)
Amortization of deferred financing fees	(3,614)
Accreted interest	1,722
Amortization of bond and note discounts	1,329
Amortization of bond and note issuance costs	4,191
Provision for loan losses	380
Net depreciation of investments	24,508
Changes in operating assets and liabilities:	
Accounts receivable	4,866
Accrued interest receivable	(2,502)
Accrued rent receivable	813
Other assets	374
Accounts payable	(45,953)
Accrued interest payable	(1,707)
Other liabilities	(1,318)
Net cash used by operating activities	(36,145)
INVESTING ACTIVITIES:	
Purchase of investments	(987,770)
Maturities of investments	883,268
Net decrease in loans receivable	96,530
Lease payments received	9,825
Net cash provided by investing activities	1,853

(Continued)

ARKANSAS DEVELOPMENT FINANCE AUTHORITY,
A COMPONENT UNIT OF THE STATE OF ARKANSAS

COMBINED STATEMENT OF CASH FLOWS
YEAR ENDED JUNE 30, 1999
(EXPRESSED IN THOUSANDS)

NONCAPITAL FINANCING ACTIVITIES:	
Proceeds from issuance of bonds and notes payable	$ 337,816
Repayments of bonds and notes payable	(350,221)
Payments of debt issuance cost	(2,305)
Collection of financing fees	1,250
Net cash used by noncapital financing activities	(13,460)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(47,752)
CASH AND CASH EQUIVALENTS:	
Beginning of year	203,593
End of year	$ 155,841
Supplemental disclosure of cash flow information - Interest paid	$ 86,993
Supplemental schedule of noncash investing activities - Real estate acquired in settlement of loans	$ 1,368

See notes to financial statements.

(Concluded)

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Arkansas Development Finance Authority (the "Authority") was created May 1, 1985, by Act 1062 of 1985 (Arkansas Development Finance Authority Act) and is a public body politic and corporate, with corporate succession, to be an independent instrumentality exercising essential public functions. Pursuant to Act 1062, the Authority is authorized and empowered to issue bonds and various other debt instruments for the purpose of financing qualified agricultural business enterprises, capital improvement facilities, educational facilities, health care facilities, housing developments, and industrial enterprises.

Bonds and other debt instruments issued by the Authority and included on the Authority's combined financial statements are special obligations of the Authority, payable solely from and collateralized by a first lien on the proceeds, monies, revenues, rights, interests and collections pledged therefore under the resolutions authorizing the particular issues. The State of Arkansas is not obligated to pay the bonds and other debt instruments, and neither the faith and credit nor the taxing power of the State of Arkansas is pledged to the payment of the principal or redemption price of, or interest on, the bonds and other debt instruments. The Authority has no taxing power.

The major accounting principles and practices followed by the Authority are presented below:

Basis of Accounting - The Authority uses the accrual method of accounting whereby expenses are recognized when the liability is incurred and revenues are recognized when earned.

Fund Accounting - The Authority's accounts are organized as funds, each of which includes accounts for the assets, liabilities, fund equity, revenues, and expenses of the Authority's programs and general fund.

The following describes the nature of the funds and significant programs currently maintained by the Authority:

(i) Single Family Housing Program Fund

(a) *Single Family Mortgage Purchase Program* - Accounts for proceeds from single family mortgage purchase bonds, the debt service requirements of the bonds, and the related mortgage loans for single family owner-occupied housing in Arkansas.

(ii) Multi-Family Housing Program Fund

(a) *Multi-Family Mortgage Purchase Program* - Accounts for the proceeds of the multi-family mortgage purchase bonds, the debt service requirements of the bonds, and the related mortgage loans for multi-family housing in Arkansas, most of which are HUD approved and insured.

(b) *Section 8 Housing Assistance Payment Program* - Accounts for Section 8 housing assistance funds received in advance, housing assistance payment disbursements, and Authority fees and expenses related to the Section 8 Housing Assistance Payment Program.

(c) *GNMA/BMIR Loan Purchase Program* - Accounts for proceeds from the sale of GNMA Guaranteed Bonds, debt service requirements on the bonds, related Below Market Interest Rate mortgages purchased with bond proceeds, disbursements to program participants of excess loan prepayments, and the Authority's fees and expenses in connection with the program.

(d) *Home Investment in Affordable Housing Program* - Accounts for federal financial assistance received from the Department of Housing and Urban Development for the purpose of developing and supporting affordable housing through tenant based rental assistance, rental rehabilitation, new construction, or assistance to homebuyers and homeowners.

(iii) Economic Development Program Fund

(a) *Development Finance Program* - Accounts for the proceeds from the sale of development revenue bonds and notes; the debt service requirements of the bonds and notes and related loans to developers, public and private institutions and government bodies within the State of Arkansas; and includes certain assets not owned and related obligations not owed by the Authority. To a limited extent and only when specified by a specific trust indenture, the payment of principal and interest on the obligations not directly owed by the Authority is guaranteed by the Authority (see Note 3).

(b) *Bond Guaranty Program* - Accounts for grants from the State Treasurer, guaranty fees collected, interest earned on deposits, and disbursements made in connection with bond guaranties provided by the Authority. The fund was created by Act 505 of 1985 which authorized a grant of $6.0 million from the State Treasurer for the purpose of enhancing and supporting the creditworthiness of bonds and other debt instruments guaranteed by the Authority. At June 30, 1999, the fund had cash and cash equivalents and investments totaling $21.0 million in the reserve account to collateralize Authority-guaranteed bonds and future issues under the bond guaranty program.

(iv) Other Programs and General Fund

(a) *ADFA General Fund* - Accounts for money transferred from other funds to the extent such transfers are permitted by the resolutions establishing other funds and to account for income and expenses not directly attributable to a program. Administrative expenses are allocated to the programs based on projected receipts in excess of debt service requirements of each program.

Cash and Cash Equivalents - Cash and cash equivalents include all cash balances and highly liquid investments with a maturity at acquisition of three months or less.

Investments **-** The Authority accounts for investments in accordance with Governmental Accounting Standards Board Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools* ("GASB 31"). GASB 31 requires that certain investments be reported at fair value and that changes in the fair value of investments be reported as a component of investment income. GNMA securities associated with the Single Family Housing Program Funds contribute significantly to the year end decline in the market value of investments. The Authority has the positive intent and ability to hold these assets as long-term investments until their original maturity date. Investments in the Other Programs and General Fund also experienced an overall decline in market value, however, the Authority has the positive intent and ability to hold these assets as long-term investments until (a) they can be sold at an economic benefit or (b) their original maturity date.

Direct Financing Leases **-** The Authority issues revenue bonds to provide financing of correction facilities and office space for the State of Arkansas but does not maintain or operate the facilities. Arrangements of this type are accounted for in the various funds as financing arrangements in accordance with the provisions of Financial Accounting Standards Board Statement No. 13, *Accounting for Leases*. Unearned income on net investment in direct financing leases is recognized using the interest method over the life of the lease.

Loans Receivable **-** Loans are recorded at cost, adjusted for any discount or premium prorated to maturity and an allowance for losses. The loans are not valued at the lower of cost or market because it is the Authority's intention to hold the loans to maturity. However, the borrower may prepay the loan or foreclosure may become necessary.

An allowance for uncollectible interest on loans is established based upon management's periodic review of loans contractually past due. The allowance is established by charges to income. Income is subsequently recognized only when cash payments are received or when, based upon a review of the loan, it appears the borrower's ability to make payments has been restored, in which case the loan is returned to accrual status.

Deferred Charges **-** Costs related to issuing bonds and notes and discount on sale of bonds and notes are capitalized and are amortized over the term of the bonds and notes based on the balance of bonds and notes outstanding. Early retirement of bonds results in proportionate amounts of amortization of bond issuance costs and discounts.

Deferred Fees, Advances, Grants, and Credits **-** The Authority receives commitment fees from lenders for earmarking funds and financing fees from borrowers. Deferred commitment fees which are nonrefundable are amortized into income ratably over the term of the respective programs based on the balance of mortgage loans outstanding.

Provision for Losses **-** Provision for losses on loans and property acquired by foreclosure has been established by management based on amounts outstanding and historical experience. Provision for losses includes charges to reduce the recorded balance of loans and property to their estimated net realizable value. Such provisions are based on management's estimate of the net realizable value of the collateral or property, as applicable, considering current and anticipated future operating or sales information which may be affected by changing economic and/or operating conditions beyond the Authority's control, thereby causing these estimates to be particularly susceptible to changes that could result in a future adjustment increasing the provision for losses and, consequently, decreasing retained earnings. Improvements in these factors and unforeseen recoveries may reduce the estimated allowance level and recover some of the previously provided allowance.

Use of Estimates - The preparation of financial statements in conformity with generally accepted accounting principles 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.

2. DEPOSITS AND INVESTMENTS

(a) Deposits - At year end the carrying amount of the Authority's deposits was approximately $6.2 million and the bank balance was $7.5 million. Of the bank balance, $.4 million was insured by federal depository insurance, $4.1 million was collateralized by collateral held in a Federal Reserve pledge account, and $3.0 million was uncollateralized and held by the counterparty in the Authority's name.

The following schedule reconciles the reported amount of deposits as disclosed above to the combined balance sheet (expressed in thousands):

Reported amount of deposits	$ 6,197
Investments disclosed as cash equivalents for GASB 3	(1,000)
Cash equivalents disclosed as investments for GASB 3	150,644
Cash and cash equivalents as reported on the combined balance sheet	$ 155,841

(b) Investments - In accordance with Governmental Accounting Standards Board Statement No. 3, *Accounting and Financial Reporting for Deposits with Financial Institutions, Investments and Reverse Repurchase Agreements*, the Authority's investments are categorized to give an indication of the level of credit risk assumed. Category 1 includes investments that are insured, collateralized or registered, or for which the securities are held by the Authority or its agent in the Authority's name. Category 2 includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in the Authority's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent but not in the Authority's name.

Investments at June 30, 1999, by security type and level of credit risk (expressed in thousands):

Security Type	Category 1	Category 2	Category 3	Reported Value
Categorized:				
U.S. Government and agency securities	$ 632,697			$ 632,697
Commercial paper	252			252
Repurchase agreement	9,056			9,056
Total investments categorized by investment type	$ 642,005			$ 642,005
Uncategorized:				
Investment agreements				$ 244,885
Mutual funds				150,644
Total uncategorized				$ 395,529
TOTAL INVESTMENTS				$ 1,037,534

Under the investment agreements noted above, monies held by the trustees of the respective issues are invested at guaranteed rates for predetermined periods of time. The investments are backed by noncollateralized promissory notes of the lending institutions; therefore, the collectibility of such investments is dependent in part on the ability of the institutions to repay the promissory notes. As discussed in Notes 1 and 6, bonds issued by the Authority are payable solely from and collateralized by a lien on the proceeds, monies, revenues, rights, interest, and collections pledged under the resolutions authorizing the particular issues; consequently, any loss from investments impacts the particular related bond fund.

The following schedule reconciles the carrying amount of investments as disclosed above to the combined balance sheet (expressed in thousands):

Reported amount of investments	$1,037,534
Investments disclosed as cash equivalents for GASB 3	1,000
Cash equivalents disclosed as investments for GASB 3	(150,644)
Investments as reported on the combined balance sheet	$ 887,890

The Authority invests in various asset and mortgage-backed securities. These securities are reported at fair value in the combined balance sheet. They are also included in the totals of U.S. Government and agency securities in the disclosure of custodial credit risk. The Authority invests in these securities to enhance yields on investments. Changes in market interest rates affect the cash flows of these securities and may result in changes in fair value. The overall return or yield on these securities depends on the changes in the interest and principal payment pattern and the market value of the underlying assets.

3. LOANS RECEIVABLE

***Single Family Mortgage Purchase Programs and Multi-Family Mortgage Purchase Programs* -** All mortgage loans purchased under the single family and multi-family mortgage purchase programs are collateralized by first liens on real property. All mortgage loans purchased by the Authority under the FHA/VA Single Family Mortgage Purchase Programs are FHA insured or VA guaranteed mortgage loans. Loans purchased under the Conventional Single Family Mortgage Purchase Program are insured up to an aggregate limit for each issue by supplemental mortgage insurance. Private mortgage insurance is required to the extent that individual loans purchased under the Conventional Single Family Mortgage Purchase Program exceed 80% of the appraised value of the property.

Each loan purchased under the GNMA/BMIR Loan Purchase Program was made pursuant to the FHA program for below market interest rate mortgage loans and is insured by the FHA pursuant to Section 212(d)(3) of Title II of the National Housing Act.

***Development Finance Programs* -** Loans to private companies for financing the acquisition or expansion of industrial facilities are collateralized by liens on and security interests in collateral granted by the companies and by guaranty agreements between the Authority and one or more guarantors. To a limited extent and only when specified by a specific trust indenture, the payment of principal and interest on the bonds is guaranteed by the Authority under the ADFA Bond Guaranty Act (Act 505 of

1985). At June 30, 1999, the Authority reported in its combined balance sheet $44.3 million nonrecourse loans to private companies and $54.7 million in related bond issues which are guaranteed by the Authority.

Also included in the Development Finance Program are financing activities with educational institutions and other various state agencies. At June 30, 1999, the Authority reported loans of $27.2 million, direct financing leases of $73.9 million, and bonds outstanding of $133.0 million related to the financing arrangements with these institutions and agencies.

Loans to educational institutions for financing the cost of equipment and other capital improvements have been approved by the bond insurer, Federal Guaranty Insurance Company, which has issued a bond insurance policy to insure payment of the principal and interest on the bonds when due.

The stated interest rates on the loans and loan servicing fees charged by the Authority are as follows:

	Stated Interest Rate	Loan Servicing Fee Rate
Single Family Housing Program Fund	5.95 to 10.25%	0.125 - 0.5%
Multi-Family Housing Program Fund	0.00 to 8.79%	0.125%
Economic Development Program Fund:		
Bond Programs	Rate on bonds	None
Other Programs	3%	None
Other Programs and General Fund	0.00 to 10.00%	None

4. NET INVESTMENT IN DIRECT FINANCING LEASES

The Authority is the lessor under various direct financing capital leases whereby the Authority issued bonds for the acquisition or construction of certain facilities and then leased the facilities to other state agencies. At the end of the lease terms, these leases either transfer ownership to the other agencies or contain bargain purchase options. Future minimum lease payments receivable under these leases which begin expiring in 2007 are as follows (expressed in thousands):

Year ending June 30:	Lease Payments
2000	$ 8,342
2001	8,346
2002	8,344
2003	8,343
2004	8,328
Thereafter	64,506
Total minimum lease payments receivable	106,209
Less amount representing interest	(32,264)
PRESENT VALUE OF MINIMUM LEASE PAYMENTS RECEIVABLE	$ 73,945

5. BONDS AND NOTES PAYABLE

Bonds and notes payable at June 30, 1999, were as follows (expressed in thousands):

Total Single Family Bonds Payable, with interest rates ranging from 3.7-11.42% and final maturity at varying dates through 2030	$ 902,299
Less unamortized discount	(385)
Plus capital appreciation	1,722
Total Single Family Mortgage Purchase Programs Bonds Payable, net	903,636
Total Multi-Family Bonds Payable, with interest rates ranging from 4.15-9.4% and final maturity at varying dates through 2027	206,009
Plus unamortized premium	259
Total Multi-Family Mortgage Purchase Programs Bonds Payable, net	206,268
Total Economic Development Bonds Payable, with interest rates ranging from 3.5-10.6% and final maturity at varying dates through 2030	266,309
Plus unamortized premium	124
Total Development Finance Programs Bonds Payable, net	266,433
TOTAL ALL PROGRAMS BONDS PAYABLE, Net	$1,376,337

Future amounts required to pay principal and interest on all bonds and notes payable at June 30, 1999, were as follows (expressed in thousands). The principal amount shown differs from the amount on the balance sheet due to unamortized premiums, discounts, and capital appreciation of $1.7 million:

	Principal	Interest	Total
Year Ending June 30:			
2000	$ 74,349	$ 78,536	$ 152,885
2001	39,369	76,538	115,907
2002	40,574	74,075	114,649
2003	42,241	71,357	113,598
2004	46,606	68,449	115,055
Thereafter	1,131,478	808,424	1,939,902
TOTAL	$ 1,374,617	$ 1,177,379	$ 2,551,996

Under the bond resolutions, the Authority has the option to redeem bonds at premiums ranging up to 5.60%. Generally, the redemption option cannot be exercised prior to the time the bonds have been outstanding for six to ten years. Certain special redemptions, at par as governed by the bond resolutions, are permitted or required prior to such time.

The bonds and notes are collateralized, as described in the applicable bond and note resolutions, by the revenues, monies, investments, mortgage loans, and other assets in the funds and accounts established by the respective bond and note resolutions.

At June 30, 1999, the Authority has an unused line of credit of $5.0 million with the Arkansas Teacher Retirement System under a $5.0 million Revolving Loan Agreement.

As of June 30, 1999, the remaining principal amounts outstanding on issues defeased in previous years are as follows (expressed in thousands):

Issue	Date of Defeasance	Principal Outstanding
1979 Series A Single Family Conventional Bonds	September 1988	$ 57,075
1982 Series A 2023 Multi-Family Term Bonds	August 1990	8,988
1988-1 Compound Accretion Bonds	December 1992	12,059

During the normal course of business, the Authority issues economic development revenue bonds on behalf of private companies within the State of Arkansas. The bonds are payable solely from and secured by a pledge of revenues from the private companies to which the bond proceeds were remitted and accordingly, have been excluded from the Authority's combined financial statements. At June 30, 1999, the economic development revenue bonds outstanding issued under this program aggregated $146 million.

6. CONCENTRATIONS OF RISK IN LENDING AND LOAN RECEIVABLE INSURANCE

The Authority, through its normal lending activity, originates and maintains loans receivable which are substantially concentrated primarily in Arkansas. The Authority's policy calls for collateral or other forms of repayment assurance to be received from the borrower at the time of loan origination. Such collateral or other form of repayment assurance is subject to changes in economic value due to various factors beyond the control of the Authority, and such changes could be significant.

Additionally, the Authority is heavily dependent on private insurers for recovery of loan principal should a borrower or borrowers not pay the principal and should any collateral prove to be insufficient in value to provide for full recovery of principal and accrued interest. This dependency is concentrated in a limited number of insurers and the Authority's ability to monitor closely the insurers' financial condition is limited.

7. RETIREMENT PLAN

The officials and employees of the Authority participate in a state-wide, multiple-employer public employee retirement system administered by the Arkansas Public Employees Retirement System (the "System"). There is no legal obligation imposed upon the member agencies relative to the operation of the System other than the payment of a percent of the gross salaries of eligible employees participating in the System as an employer contribution. State law provides that Authority contributions for all covered state employees are to be based on 10% of gross payroll. All contributions required of the Authority were made for the year ended June 30, 1999. For the year ended June 30, 1999, the Authority's covered payroll and total payroll for all employees amounted to approximately $2.3 million.

The contributory plan has been in effect since the beginning of the System, and is available to all persons who became members before January 1, 1978. The noncontributory plan was effective January 1, 1978, and applies automatically to all persons hired January 1, 1978, or later in System covered employment. Employees joining the System prior to July 1, 1997, are vested after ten years of employment. Beginning July 1, 1997, the vesting period for new members will be reduced to five years. A member covered by the contributory plan can elect to be covered by the noncontributory plan, and the change will be effective January 1, 1978, regardless of when the election was made. The

System is audited separately, and included therein is financial data and trend information which gives an indication of the extent to which the system is accumulating sufficient assets to pay benefits when due.

8. CONTINGENCIES

The Authority participates in numerous 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 adjustment by the grantor agencies; therefore, to the extent that the Authority 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, 1999, may be impaired. In the opinion of the Authority, 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 combined financial statements for such contingencies.

The Authority has $33.2 million of amounts recorded as cash and investments reported in the combined balance sheet that will be disbursed to borrower's under loan agreements closed prior to June 30, 1999.

At June 30, 1999, the Authority is in the process of evaluating any possible liability related to rebatable arbitrage due on its outstanding or defeased bond issues. Management of the Authority believes that this evaluation will not have a material adverse impact on the financial statements; therefore, no provision for arbitrage rebate has been recorded in the accompanying financial statements.

9. RESTATEMENT OF PRIOR YEAR RETAINED EARNINGS

Retained earnings at June 30, 1998, has been restated as follows (expressed in thousands):

Retained earnings as previously reported	$ 142,603
Correction of prior year amounts	(9,888)
Retained earnings at June 30, 1998, as adjusted	$ 132,715

Management of the Authority has restated retained earnings by approximately $9.9 million to remove the Safe Drinking Water Fund, the Construction Assistance Revolving Loan Fund, and the College Savings Bond Revolving Loan Repayment Fund from the combined financial statements. Removal of these programs more appropriately reflects the relationship of the Authority and other State of Arkansas agencies in accordance with the requirements of GASB Statement No. 14, *The Financial Reporting Entity*.

10. SUBSEQUENT EVENTS

Subsequent to June 30, 1999, the Authority issued approximately $65 million in special obligation bonds in the Single Family Housing Programs Fund, $23 million in special obligation bonds in the Multi-Family Housing Programs Fund, and $24 million in special obligation bonds in the Economic Development Programs Fund.

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REQUIRED SUPPLEMENTARY INFORMATION
YEAR 2000 DISCLOSURE (UNAUDITED)

REQUIRED SUPPLEMENTARY INFORMATION (UNAUDITED)

The Year 2000 Issue

The year 2000 issue arises because most computer software programs allocate two digits to the year date on the assumption that the first two digits will be *19*. Without reprogramming, such programs will interpret the year 2000 as the year 1900. Also, some programs may be unable to recognize that the year 2000 is a leap year.

The year 2000 issue may affect electronic equipment containing computer chips that have date recognition features—such as environmental systems, elevators, and vehicles—as well as computer software programs. In addition, the year 2000 issue affects not only computer applications and equipment under the Authority's direct control, but also the systems of the entities with which the Authority transacts business ("third party vendors").

Because of the unprecedented nature of the year 2000 issue, its effects and the success of related remediation efforts will not be fully determinable until the year 2000 and thereafter. Management cannot assure that the Authority is or will be year 2000 ready, that the Authority's remediation efforts will be successful in whole or in part, or that the third party vendors of the Authority will be year 2000 ready.

At any given time, work to address the year 2000 issue, with respect to each system deemed mission-critical (i.e., critical to conducting the Authority's operations) falls predominantly within one of the following stages of work:

- (i) Awareness stage - Establishing a budget and a project plan for dealing with the year 2000 issue.
- (ii) Assessment stage - Identifying the systems and components for which year 2000 work is needed.
- (iii) Remediation stage - Making changes to systems and equipment.
- (iv) Validation and Testing stage - Validating and testing changes that were made during the remediation stage.

The following paragraphs summarize year 2000 state-of-work data for the Authority's mission critical systems and equipment as of June 30, 1999.

The Authority began its year 2000 work in mid-1996 with inventory, assessment and project planning work related to its mission-critical systems. The awareness and assessment phases were completed in late 1996 resulting in estimates for resources and training. The Authority determined internal resources would primarily be used to reprogram or replace, test and implement hardware and software changes for year 2000 modifications. Internal resources include both employees of the Authority and resources provided by the State of Arkansas. A budget for external resources, such as outside validation and software upgrades necessary to address the year 2000 issue, was not formally established during the awareness and assessment phases. However, it is estimated less than $100,000 has been expended from the general fund for external resources related to the year 2000 issue. The Authority does not anticipate any significant expenditures related to year 2000 work after year end through December 31, 1999.

In August 1998 planning began for an independent review of the readiness (validation) of the Authority for the year 2000 issue. This review was completed in June 1999 with no urgent action required. The primary recommendation resulting from this review was for the Authority to identify and include in its contingency plan manual processes for its most mission critical business functions should the Authority's network not be functional.

The Authority continues to monitor third party vendors for indication of year 2000 readiness. As of June 30, 1999, the Authority estimated over 80% of the Authority's third party vendors were compliant with regard to year 2000 readiness. In addition, as of June 30, 1999, the Authority continues researching and downloading applicable service packs on workstations as necessary, as a further prevention of any possible minimal interruptions.

Because of the size and complexity of the year 2000 problem, certain failures can be expected. To mitigate this risk, certain members of the Authority's staff will be required to (1) pre-test all mission-critical software packages November 30, 1999, in a mirrored Authority network environment (simulated lab) operating in the first two months of the year 2000, and (2) to test critical software packages remotely the first three days of the year 2000, to ensure all mission critical software is functioning prior to the first business day of the year 2000. If remote access is unavailable, these staff members will report to the Authority office to complete the testing. If there is power or system failure, these tests will be performed upon restoration of service.

ARKANSAS DEVELOPMENT FINANCE AUTHORITY,
A COMPONENT UNIT OF THE STATE OF ARKANSAS

ADDITIONAL INFORMATION - COMBINING BALANCE SHEET
JUNE 30, 1999
(EXPRESSED IN THOUSANDS)

	Single Family Housing Program Fund	Multi-Family Housing Program Fund	Economic Development Program Fund	Other Programs and General Fund	Eliminations	Total
ASSETS						
Cash and cash equivalents	$ 66,165	$ 38,002	$ 43,621	$ 8,053		$ 155,841
Accounts receivable	1,555	724		4,907	$ (4,389)	2,797
Accrued interest receivable	3,641	1,727	2,659	722		8,749
Accrued rent receivable			906			906
Investments, at fair value	767,332	33,750	60,603	26,205		887,890
Loans receivable, net	101,102	166,608	140,864	629		409,203
Deferred charges	9,451	2,676	4,015			16,142
Direct financing leases			73,945			73,945
Real estate owned			1,368			1,368
Capitalized assets, net		5		470		475
TOTAL ASSETS	$ 949,246	$ 243,492	$ 327,981	$ 40,986	$ (4,389)	$ 1,557,316
LIABILITIES AND RETAINED EARNINGS						
Accounts payable	$ 253	$ 4,447	$ 1,764	$ 501	$ (4,389)	$ 2,576
Accrued interest payable	20,496	3,062	2,847			26,405
Bonds and notes payable, net of unamortized discounts and premiums	903,636	206,268	266,433			1,376,337
Deferred fees, advances, grants, and credits	6,811	951	22,444	12		30,218
Total liabilities	931,196	214,728	293,488	513	(4,389)	1,435,536
COMMITMENTS AND CONTINGENCIES						
RETAINED EARNINGS:						
Reserved for programs	18,050	28,764	34,493			81,307
Unreserved				40,473		40,473
Total retained earnings	18,050	28,764	34,493	40,473		121,780
TOTAL LIABILITIES AND RETAINED EARNINGS	$ 949,246	$ 243,492	$ 327,981	$ 40,986	$ (4,389)	$ 1,557,316

ARKANSAS DEVELOPMENT FINANCE AUTHORITY,
A COMPONENT UNIT OF THE STATE OF ARKANSAS

ADDITIONAL INFORMATION - COMBINING STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN RETAINED EARNINGS
YEAR ENDED JUNE 30, 1999
(EXPRESSED IN THOUSANDS)

	Single Family Housing Program Fund	Multi-Family Housing Program Fund	Economic Development Program Fund	Other Programs and General Fund	Eliminations	Total
REVENUES:						
Investment income:						
Loans and direct financing lease income	$ 9,859	$ 8,868	$ 12,987	$ 47		$ 31,761
Interest and dividends	50,955	1,909	5,566	2,352		60,782
Amortization of discounts on loans		8,299				8,299
Financing fee income	2,250	392	1,240	3,120	$ (2,138)	4,864
Net appreciation (depreciation) in the fair value of investments	(21,977)	983	(459)	(3,055)		(24,508)
Total investment income	41,087	20,451	19,334	2,464	(2,138)	81,198
Federal financial assistance		17,182				17,182
Other income	105	43	65	78		291
Total revenues	41,192	37,676	19,399	2,542	(2,138)	98,671
EXPENSES:						
Interest on bonds and notes:						
Current interest	52,344	17,678	13,542			83,564
Accreted interest	1,722					1,722
Total interest on bonds and notes	54,066	17,678	13,542			85,286
Amortization:						
Amortization of discounts and premiums on bonds and notes	606	542	181			1,329
Amortization of bond and note issuance costs	2,619	1,120	454	(2)		4,191
Total amortization	3,225	1,662	635	(2)		5,520
Administrative expenses:						
Provision for loan losses			234	146		380
Federal financial assistance programs		12,350			(1,093)	11,257
Salaries and benefits				2,885		2,885
Operations and maintenance				552		552
Other	2,928	809	549	485	(1,045)	3,726
Total administrative expenses	2,928	13,159	783	4,068	(2,138)	18,800
Total expenses	60,219	32,499	14,960	4,066	(2,138)	109,606
NET INCOME (LOSS) BEFORE TRANSFERS FROM (TO) OTHER FUNDS	(19,027)	5,177	4,439	(1,524)		(10,935)

(Continued)

ARKANSAS DEVELOPMENT FINANCE AUTHORITY,
A COMPONENT UNIT OF THE STATE OF ARKANSAS

ADDITIONAL INFORMATION - COMBINING STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN RETAINED EARNINGS
YEAR ENDED JUNE 30, 1999
(EXPRESSED IN THOUSANDS)

	Single Family Housing Program Fund	Multi-Family Housing Program Fund	Economic Development Program Fund	Other Programs and General Fund	Eliminations	Total
OPERATING TRANSFERS FROM (TO) OTHER FUNDS	$ 1,335	$ (109)	$ (41)	$ (1,185)	$ -	$ -
NET INCOME (LOSS)	(17,692)	5,068	4,398	(2,709)		(10,935)
RETAINED EARNINGS:						
Beginning of year, as adjusted	35,141	7,504	12,197	77,873		132,715
Residual equity transfers	601	16,192	17,898	(34,691)		
End of year	$ 18,050	$ 28,764	$ 34,493	$ 40,473	$ -	$ 121,780

(Concluded)