

State of Arkansas Safe Drinking Water Fund

*Financial Statements for the Years
Ended June 30, 2002 and 2001,
and Independent Auditors' Report*

STATE OF ARKANSAS SAFE DRINKING WATER FUND

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STATE OF ARKANSAS SAFE DRINKING WATER FUND

MANAGEMENT DISCUSSION AND ANALYSIS

This discussion and analysis is designed to assist the reader in focusing on significant issues and activities and to identify any significant changes in the financial position of the Safe Drinking Water Fund (the "Fund"). Readers are encouraged to consider the information presented in conjunction with the financial statements and notes as a whole.

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, 2001, are also presented. Although not required, these comparative totals are intended to facilitate an enhanced understanding of the Fund's financial position and results of operations for the current fiscal year in comparison to the prior fiscal year.

CONDENSED FINANCIAL INFORMATION - STATEMENT OF NET ASSETS (In thousands)

	2002	2001
Total assets	<u>\$ 16,142</u>	<u>\$ 12,602</u>
Total liabilities	<u>1,963</u>	<u>308</u>
Total net assets - restricted by program requirements	<u>\$ 14,179</u>	<u>\$ 12,294</u>

The Fund's total assets increased 28.1% to \$16.1 million at June 30, 2002, compared to \$12.6 million at June 30, 2001. The increase is attributed to the funding of \$400 thousand of the \$3.9 million in new loans approved during the year as well as disbursements of \$3.9 million related to existing loans. The Fund issued one loan for fiscal 2002 to the City of Camden. The construction period for the loans of the Fund is approximately two years. Accounts receivable balance of \$1.1 million represents the amount due from the Environmental Protection Agency for the reimbursement of expense incurred by the Department of Health and paid by the Fund.

The Fund's total liabilities increased 84.3% to \$2 million at June 30, 2002, from \$308 thousand at June 30, 2001. The increase is primarily attributed to the accrual for the program administration expense of \$1.4 million.

CONDENSED FINANCIAL INFORMATION - STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS (In thousands)

	2002	2001
Total investment income	\$ 299	\$ 389
Other income	<u>80</u>	<u>31</u>
Total operating revenues	379	420
Administrative expenses	<u>1,759</u>	<u>1,729</u>
OPERATING LOSS	(1,380)	(1,309)
CAPITAL GRANTS AND CONTRIBUTIONS	<u>3,265</u>	<u>5,741</u>
CHANGE IN NET ASSETS	1,885	4,432
NET ASSETS:		
Beginning of year	<u>12,294</u>	<u>7,862</u>
End of year	<u>\$ 14,179</u>	<u>\$ 12,294</u>

Operating loss and capital grants and contributions offset to a net increase in net assets of \$1.9 million for the fiscal year ended June 30, 2002. The change in net assets decreased \$2.5 million compared to fiscal 2001, attributable to the decrease in the amount of capital grants and contributions received. Revenues from investments declined \$90 thousand, with the average return on cash, cash equivalents and investments of 2.3% in 2002 compared to 5.6% in 2001.

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

INDEPENDENT AUDITORS' REPORT

The Commissioners of the
Arkansas Soil and Water Conservation Commission

The Board of Directors of
Arkansas Development Finance Authority:

We have audited the accompanying statement of net assets of the State of Arkansas Safe Drinking Water Fund (the "Fund") as of June 30, 2002, and the related statements of revenues, expenses, and changes in net assets and of cash flows for the year ended June 30, 2002. These financial statements are the responsibility of management of the Arkansas Soil and Water Conservation Commission, Arkansas Department of Health, and Arkansas Development Finance Authority. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements of the Fund 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 Fund. They do not purport to, and do not, present fairly the financial position of the State as of June 30, 2002, and the changes in its financial position and its cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Fund as of June 30, 2002, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 1 to the financial statements, in 2002, the Fund adopted Governmental Accounting Standards Board ("GASB") Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - State and Local Governments*; GASB Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus*; and GASB Statement No. 38, *Certain Financial Statement Note Disclosures*.

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 principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued a report dated October 9, 2002, on our consideration of the Fund'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.

Deloitte & Touche LLP

October 9, 2002
Little Rock, Arkansas

STATE OF ARKANSAS SAFE DRINKING WATER FUND

STATEMENTS OF NET ASSETS

JUNE 30, 2002 AND 2001 (expressed in thousands)

ASSETS	2002	2001
Cash and cash equivalents	\$ 4,973	\$ 6,303
Accrued interest receivable	7	21
Accounts receivable	1,139	
Loans receivable, net	10,023	6,270
Equipment, net	<u>8</u>	<u>8</u>
Total assets	<u>16,142</u>	<u>12,602</u>
 LIABILITIES		
Accounts payable	1,411	15
Deferred fees	<u>552</u>	<u>293</u>
Total liabilities	<u>1,963</u>	<u>308</u>
 COMMITMENTS AND CONTINGENCY		
 NET ASSETS		
RESTRICTED BY PROGRAM REQUIREMENTS	<u>\$14,179</u>	<u>\$12,294</u>

See notes to financial statements.

STATE OF ARKANSAS SAFE DRINKING WATER FUND

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS YEAR ENDED JUNE 30, 2002 AND 2001 (expressed in thousands)

	2002	2001
OPERATING REVENUES:		
Interest income:		
Investments	\$ 122	\$ 330
Loans	<u>177</u>	<u>59</u>
Total interest income	299	389
Amortization of financing fees	<u>80</u>	<u>31</u>
Total operating revenues	379	420
OPERATING EXPENSES -		
Program administration	<u>1,759</u>	<u>1,729</u>
OPERATING LOSS	(1,380)	(1,309)
CAPITAL GRANTS AND CONTRIBUTIONS	<u>3,265</u>	<u>5,741</u>
CHANGE IN NET ASSETS	1,885	4,432
NET ASSETS:		
Beginning of year	<u>12,294</u>	<u>7,862</u>
End of year	<u>\$14,179</u>	<u>\$12,294</u>

See notes to financial statements.

STATE OF ARKANSAS SAFE DRINKING WATER FUND

STATEMENTS OF CASH FLOWS

YEAR ENDED JUNE 30, 2002 AND 2001(expressed in thousands)

	2002	2001
OPERATING ACTIVITIES:		
Interest received on investments	\$ 136	\$ 332
Interest received on loans	177	64
Other cash paid	(1,131)	32
Cash paid for program administration	<u>(363)</u>	<u>(1,800)</u>
Net cash used in operating activities	(1,181)	(1,372)
NONCAPITAL FINANCING ACTIVITIES -		
Nonoperating grants received	<u>3,265</u>	<u>5,741</u>
CAPITAL AND RELATED FINANCING ACTIVITIES -		
Loan cost of issuance paid by borrowers	<u>339</u>	<u>137</u>
INVESTING ACTIVITIES:		
Loan disbursements	(3,853)	(4,727)
Principal repayments on loans	<u>100</u>	<u> </u>
Net cash used in investing activities	(3,753)	(4,727)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(1,330)	(221)
CASH AND CASH EQUIVALENTS:		
Beginning of year	<u>6,303</u>	<u>6,524</u>
End of year	<u>\$ 4,973</u>	<u>\$ 6,303</u>
RECONCILIATION OF OPERATING LOSS TO NET CASH USED IN OPERATING ACTIVITIES:		
Operating loss	\$ (1,380)	\$ (1,309)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation and amortization	8	1
Changes in operating assets and liabilities:		
Accrued interest receivable	14	7
Accounts receivable	(1,139)	
Deferred fees and other assets	(80)	
Accounts payable	<u>1,396</u>	<u>(71)</u>
Net cash used in operating activities	<u>\$ (1,181)</u>	<u>\$ (1,372)</u>

See notes to financial statements.

STATE OF ARKANSAS SAFE DRINKING WATER FUND

NOTES TO FINANCIAL STATEMENTS YEAR ENDED JUNE 30, 2002 AND 2001

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Act 772 of 1997 (the "Act") authorized the establishment of a fund known as the Safe Drinking Water Fund (the "Fund") to be maintained by the Arkansas Development Finance Authority ("ADFA"), and administered by the Arkansas Soil and Water Conservation Commission (the "Commission"). The Fund is to be capitalized with federal grants and state matching funds on a ratio of five (5) federal dollars to one (1) state dollar. The Act authorized the Fund to receive federal grants, state matching grants, other grants, proceeds of bonds issued by ADFA or the Commission for the Fund, 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 Fund, and used for other purposes related to the program.

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

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

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

Net Assets Restricted by Program Requirements - Represents funds restricted due to the specific provisions of the Fund.

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.

Recently Issued Accounting Pronouncement - In June 1999, GASB issued Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments* ("GASB 34"), as amended by GASB Statement No. 37 *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus*, and by GASB Statement No. 38, *Certain Financial Statement Disclosures*. GASB Statement No. 34, as amended and commonly referred to as the new reporting model, retained much of the old reporting and disclosure requirements under the prior reporting model, with certain modifications and newly added information. This statement was implemented by the Fund for the year ended June 30, 2002. Prior year amounts have been restated for comparability purposes. The adoption of GASB 34 did not have a material impact on beginning net assets (retained earnings) as previously reported.

2. CASH AND CASH EQUIVALENTS

At June 30, 2002, cash equivalents of approximately \$5 million were invested in money market mutual funds with variable interest rates.

3. LOANS RECEIVABLE

The Fund originates loans with Arkansas municipalities for financing the construction of drinking water treatment facilities which are payable in annual installments. At June 30, 2002, such loans had a carrying value of approximately \$10 million, of which \$7.6 million is for projects still under construction. The loans bear interest at 2.5% to 2.9%, and are collateralized by sales and use tax bonds issued by the municipalities, special assessments, or user charges.

Through the year ended June 30, 2002, \$19.9 million was approved for funding. At June 30, 2002, \$9.8 million remained encumbered and awaiting disbursement to loan recipients.

4. CONTINGENCY

The Fund 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 adjustment by the grantor agencies; therefore, to the extent that the Fund 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, 2002, may be impaired. In the opinion of the management of the Fund, 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.

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