

**State of Arkansas Safe Drinking Water
Revolving Loan Fund Program**

Accountants' Report and Financial Statements

June 30, 2012 and 2011



**State of Arkansas Safe Drinking Water
Revolving Loan Fund Program
June 30, 2012 and 2011**

Contents

| | |
|--|----------|
| Independent Accountants' Report on Financial Statements and Supplementary Information | 1 |
| Management's Discussion and Analysis | 3 |
| Financial Statements | |
| Statements of Net Assets | 8 |
| Statements of Revenues, Expenses and Changes in Net Assets | 9 |
| Statements of Cash Flows | 10 |
| Notes to Financial Statements | 11 |
| Supplementary Information | |
| Combining Statement of Net Assets..... | 18 |
| Combining Statement of Revenues, Expenses and Changes in Net Assets | 19 |
| Combining Statement of Cash Flows | 20 |

Independent Accountants' Report on Financial Statements and Supplementary Information

The Commissioners of the Arkansas Natural
Resources Commission (ANRC)

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

We have audited the accompanying basic financial statements of the State of Arkansas Safe Drinking Water Revolving Loan Fund Program (the Program) as of and for the years ended June 30, 2012 and 2011, as listed in the table of contents. 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. 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, 2012 and 2011, 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, 2012 and 2011, and 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 Arkansas Natural
Resources Commission (ANRC)

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

Page 2

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis information 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.

Our audit was conducted for the purpose of forming an opinion on the basic 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 basic 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 basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic 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 basic financial statements as a whole.

BKD, LLP

October 30, 2012

**State of Arkansas Safe Drinking Water
Revolving Loan Fund Program
Management's Discussion and Analysis
June 30, 2012 and 2011**

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, 2012, 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 years ended June 30, 2011 and 2010, 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 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 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 Asset

(In thousands)

| | 2012 | 2011 | 2010 |
|--|--------------------------|--------------------------|--------------------------|
| Total assets | \$ <u>204,197</u> | \$ <u>162,274</u> | \$ <u>139,439</u> |
| Current liabilities | 600 | 392 | 356 |
| Noncurrent liabilities | <u>30,717</u> | <u>2,775</u> | <u>2,940</u> |
| Total liabilities | <u>31,317</u> | <u>3,167</u> | <u>3,296</u> |
| Total net assets – restricted for program requirements | \$ <u><u>172,880</u></u> | \$ <u><u>159,107</u></u> | \$ <u><u>136,143</u></u> |

The Program's total assets have continually increased over the past three years, primarily attributed to growth in the Program's loans for water system projects. Loans receivable – restricted increased to \$151.6 million at June 30, 2012, from \$135.6 million and \$112.0 million at June 30, 2011 and 2010, respectively.

**State of Arkansas Safe Drinking Water
Revolving Loan Fund Program
Management's Discussion and Analysis
June 30, 2012 and 2011**

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

| | 2012 | 2011 | 2010 |
|----------------------------------|------------------|------------------|------------------|
| Loan disbursements | \$ 19,954 | \$ 27,128 | \$ 14,992 |
| Loan repayments | <u>3,948</u> | <u>3,545</u> | <u>2,699</u> |
| Net increase in loans receivable | <u>\$ 16,006</u> | <u>\$ 23,583</u> | <u>\$ 12,293</u> |

Grants from the United States Environmental Protection Agency (EPA) comprised 39%, 57% and 77% of the funding source of the loan disbursements for fiscal years ended June 30, 2012, 2011, and 2010, respectively. The Program received federal funds in the form of a Base annual grant and, in prior years, an American Recovery and Reinvestment Act (ARRA) grant. The table below reflects the amounts used from each funding source for fiscal years 2012, 2011 and 2010 as follows (in thousands):

| | 2012 | 2011 | 2010 |
|-------------------------|------------------|------------------|------------------|
| EPA Federal | | | |
| Base | \$ 7,855 | \$ 10,945 | \$ 3,941 |
| ARRA | - | 4,605 | 7,630 |
| State Matching | 4,125 | 3,683 | 1,044 |
| Fees and Expenses Fund | - | 3,296 | 824 |
| Revolving Program Funds | <u>7,974</u> | <u>4,599</u> | <u>1,553</u> |
| | <u>\$ 19,954</u> | <u>\$ 27,128</u> | <u>\$ 14,992</u> |

The construction period for the loans of the Program is approximately two years.

In fiscal year 2012, the Program began funding principal forgiveness from the Base capitalization grant as required by EPA. Each construction draw is forgiven at the time of the draw. The Program awarded a grant to one borrower and forgave \$178,000.

The Program maintains liquidity for funding loans. In fiscal year 2012, the Program invested excess funds in U.S. Treasury and agencies obligations and in money market mutual funds, from time to time, as well to allow for re-evaluation of the Program's liquidity needs. At June 30, 2012, the Program's current liabilities increased \$208,000 from June 30, 2011, and \$36,000 from June 30, 2010. The increases were attributed to the Program's administration fees payable to the Department of Health (DOH) and the Arkansas Development Finance Authority (ADFA) and accrued interest payable. The amounts due to DOH were \$375,000, \$280,000 and \$260,000 at June 30, 2012, 2011 and 2010, respectively, which is reimbursed directly from the EPA Federal Base grant. ADFA receives an annual administrative fee, based on a percentage of the fiscal year end outstanding loan balance. The amounts due to ADFA were \$127,000, \$113,000 and \$95,000 for years ended June 30, 2012, 2011 and 2010, respectively. In fiscal year 2012, the Program issued the 2011 C Revolving Loan Fund Program Revenue Bonds, Series 2011 C (Series 2011 C) in the amount of \$57.0 million in conjunction with the Construction Assistance Revolving Loan Fund Program, which resulted in accrued interest payable of \$98,000.

**State of Arkansas Safe Drinking Water
Revolving Loan Fund Program
Management's Discussion and Analysis
June 30, 2012 and 2011**

Noncurrent liabilities reflected an increase of \$28.1 million in bonds payable for the issuance of the Series 2011 C and premiums paid on the bonds (that portion attributed to this Program). This was slightly offset by a decrease in deferred fees, which reflected the accretion of a 3% loan-closing fee, which the Arkansas Natural Resources Commission (ANRC) discontinued in March 2009.

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

(In thousands)

| | <u>2012</u> | <u>2011</u> | <u>2010</u> |
|-------------------------------|-------------------|-------------------|-------------------|
| Total interest income | \$ 2,978 | \$ 2,638 | \$ 2,363 |
| Other income | <u>1,611</u> | <u>1,426</u> | <u>1,222</u> |
| Total operating revenues | <u>4,589</u> | <u>4,064</u> | <u>3,585</u> |
| Program administration | 160 | 146 | 150 |
| Federal financial assistance | 303 | 5,882 | 6,243 |
| Total interest on bonds | 757 | - | - |
| Total amortization expense | <u>(266)</u> | <u>-</u> | <u>-</u> |
| Total administrative expenses | <u>954</u> | <u>6,028</u> | <u>6,393</u> |
| Operating income (loss) | 3,635 | (1,964) | (2,808) |
| Transfers (out) in, net | (1,050) | 343 | (1,263) |
| Federal grants | <u>11,188</u> | <u>24,585</u> | <u>21,086</u> |
| Change in net assets | 13,773 | 22,964 | 17,015 |
| Net assets | | | |
| Beginning of year | <u>159,107</u> | <u>136,143</u> | <u>119,128</u> |
| End of year | <u>\$ 172,880</u> | <u>\$ 159,107</u> | <u>\$ 136,143</u> |

Included in total interest income is interest earned on loans, which has increased to \$3.0 million for the year ended June 30, 2012, from \$2.6 million for the year ended June 30, 2011, and \$2.4 million for the year ended June 30, 2010. The attributing factor to the increase is the continuous funding of loans at a faster pace than repayments in the Program. Revenues from investments remained constant in the current year, attributable to the continuously low money market interest rates over the past year. The average returns on cash, cash equivalents and investments for fiscal year 2012 have decreased to 0.02%; whereas the average returns for 2011 and 2010 remained constant at 0.1% for those years.

**State of Arkansas Safe Drinking Water
Revolving Loan Fund Program
Management's Discussion and Analysis
June 30, 2012 and 2011**

For fiscal year 2012, operating expenses declined \$5.1 million. The decrease was due to a decline of \$5.8 million related to the granting of ARRA federal funds to various municipalities for water improvements, which was offset by a net increase of \$491,000 in bond interest expense and amortization of bond issuance cost and premiums on the Series 2011 C bonds. All ARRA funds were disbursed as of June 30, 2012.

Operating expenses decreased during fiscal year 2011 primarily due to the Program expensing \$5.9 million for the year ended June 30, 2011, in principal forgiveness loans, which were funded only with ARRA federal funds as compared to expensing \$6.2 million for the year ended June 30, 2010.

For the year ended June 30, 2012, the change in net assets of \$13.8 million declined \$9.2 million. The decline was primarily related to the decline in federal grants received of \$13.4 million, which was offset by a net decrease of \$1.4 million in transfers in and out to other state agencies.

The change in net assets of \$23.0 million for the year ended June 30, 2011, increased \$5.9 million in comparison to the fiscal year ended June 30, 2010. The increase in the change in net assets was primarily attributable to the increase of \$3.5 million in federal grants received and the net increase in transfers in and out of \$1.6 million.

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.

The Program received transfers in from the ANRC Water, Waste Disposal and Pollution Abatement Facilities General Obligation Bond Fund Program, which represented the state matching funds for the Program. Transfers in were offset by transfers out to other agencies for the reimbursement of expenses relating to the administration of the Program. The transfers in and out are represented in the following table (in thousands):

| | <u>2012</u> | <u>2011</u> | <u>2010</u> |
|-------------------------|-------------------|---------------|-------------------|
| ANRC-state match | \$ 2,512 | \$ 3,572 | \$ 2,045 |
| Department of Health | (3,042) | (2,709) | (2,788) |
| ANRC-administration | <u>(520)</u> | <u>(520)</u> | <u>(520)</u> |
| Transfers (out) in, net | <u>\$ (1,050)</u> | <u>\$ 343</u> | <u>\$ (1,263)</u> |

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

**State of Arkansas Safe Drinking Water
Revolving Loan Fund Program
Management's Discussion and Analysis
June 30, 2012 and 2011**

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 Assets

June 30, 2012 and 2011

(In thousands)

| | 2012 | 2011 |
|--|------------|------------|
| Current Assets | | |
| Cash and cash equivalents | \$ 33,616 | \$ 25,944 |
| Accrued interest receivable | 240 | 196 |
| Accounts receivable | | |
| Borrowers | 147 | 113 |
| Environmental Protection Agency | 375 | 393 |
| Investments – current portion | 10,000 | - |
| Total current assets | 44,378 | 26,646 |
| Noncurrent Assets | | |
| Investments – restricted | 8,004 | - |
| Loans receivable – restricted | | |
| Construction | 147,514 | 131,508 |
| Northeast Arkansas Public Water Authority | 4,120 | 4,120 |
| Other assets | 181 | - |
| Total noncurrent assets | 159,819 | 135,628 |
| Total assets | 204,197 | 162,274 |
| Current Liabilities | | |
| Accounts payable | 502 | 392 |
| Accrued interest payable | 98 | - |
| Total current liabilities | 600 | 392 |
| Noncurrent Liabilities | | |
| Bonds payable, net of unamortized premiums | 28,112 | - |
| Deferred fees | 2,605 | 2,775 |
| Total noncurrent liabilities | 30,717 | 2,775 |
| Total liabilities | 31,317 | 3,167 |
| Net Assets | | |
| Restricted for program requirements | \$ 172,880 | \$ 159,107 |

**State of Arkansas Safe Drinking Water
Revolving Loan Fund Program**
Statements of Revenues, Expenses and Changes in Net Assets
Years Ended June 30, 2012 and 2011

(In thousands)

| | <u>2012</u> | <u>2011</u> |
|---|-------------------|-------------------|
| Operating Revenues | | |
| Interest on investments | \$ 7 | \$ 6 |
| Interest on loans | 2,971 | 2,632 |
| Financing fees | 1,613 | 1,420 |
| Net (depreciation) appreciation of investments | <u>(2)</u> | <u>6</u> |
| Total operating revenues | <u>4,589</u> | <u>4,064</u> |
| Operating Expenses | | |
| Program administration | 160 | 146 |
| Federal financial assistance | | |
| Base federal grants | 178 | - |
| American Recovery and Reinvestment Act federal grants | 125 | 5,882 |
| Bond interest | 757 | - |
| Amortization of bond issuance costs | 14 | - |
| Amortization of bond premiums | <u>(280)</u> | <u>-</u> |
| Total operating expenses | <u>954</u> | <u>6,028</u> |
| Operating Income (Loss) | 3,635 | (1,964) |
| Nonoperating Revenue | | |
| Base federal grants | 11,063 | 14,098 |
| American Recovery and Reinvestment Act federal grants | <u>125</u> | <u>10,487</u> |
| Total nonoperating revenue | <u>11,188</u> | <u>24,585</u> |
| Income Before Transfers (Out) In, Net | 14,823 | 22,621 |
| Transfers (Out) In, Net | <u>(1,050)</u> | <u>343</u> |
| Change in Net Assets | 13,773 | 22,964 |
| Net Assets, Beginning of Year | <u>159,107</u> | <u>136,143</u> |
| Net Assets, End of Year | <u>\$ 172,880</u> | <u>\$ 159,107</u> |

**State of Arkansas Safe Drinking Water
Revolving Loan Fund Program
Statements of Cash Flows
Years Ended June 30, 2012 and 2011**

| <i>(In thousands)</i> | 2012 | 2011 |
|---|-------------|-------------|
| Operating Activities | | |
| Interest received on loans | \$ 2,936 | \$ 2,561 |
| Interest (paid) received on investments | (3) | 8 |
| Loan disbursements | (19,954) | (27,128) |
| Principal repayments on loans | 3,948 | 3,545 |
| Financing fees | 1,410 | 1,208 |
| Federal grant funds expended | (303) | (5,882) |
| Cash paid for interest | (660) | - |
| Cash paid for program administration | (145) | (128) |
| Net cash used in operating activities | (12,771) | (25,816) |
| Noncapital Financing Activities | | |
| Proceeds from bond issuance | 28,393 | - |
| Cash paid for cost of issuance on long-term debt | (195) | - |
| Transfers (out) in | (955) | 362 |
| Nonoperating grants received | 11,206 | 24,454 |
| Net cash provided by noncapital financing activities | 38,449 | 24,816 |
| Investing Activities | | |
| Proceeds from sale of investments | - | 11,000 |
| Purchase of investments | (18,006) | (6,994) |
| Net cash (used in) provided by investing activities | (18,006) | 4,006 |
| Increase in Cash and Cash Equivalents | 7,672 | 3,006 |
| Cash and Cash Equivalents, Beginning of Year | 25,944 | 22,938 |
| Cash and Cash Equivalents, End of Year | \$ 33,616 | \$ 25,944 |
| Reconciliation of Operating Income (Loss) to Net Cash Used in Operating Activities | | |
| Operating income (loss) | \$ 3,635 | \$ (1,964) |
| Items not providing operating activities cash flows | | |
| Amortization of bond issuance costs | 14 | - |
| Amortization of bond premiums | (280) | - |
| Amortization of deferred financing fees | (170) | (165) |
| Net depreciation (appreciation) of investments | 2 | (6) |
| Changes in | | |
| Accrued interest receivable | (44) | (69) |
| Accounts receivable – borrowers | (34) | (47) |
| Loans receivable | (16,006) | (23,583) |
| Accounts payable | 14 | 18 |
| Accrued interest payable | 98 | - |
| Net cash used in operating activities | \$ (12,771) | \$ (25,816) |

State of Arkansas Safe Drinking Water Revolving Loan Fund Program

Notes to Financial Statements

June 30, 2012 and 2011

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, 2012 and 2011, were \$127,000 and \$113,000, 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 assets. 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.

State of Arkansas Safe Drinking Water Revolving Loan Fund Program

Notes to Financial Statements

June 30, 2012 and 2011

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.

Recently Issued Accounting Pronouncements

GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, is effective for periods beginning after December 15, 2011. It provides a new statement of net position format to report all assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position (which is the net residual amount of the other elements). This Statement requires that deferred outflows of resources and deferred inflows of resources be reported separately from assets and liabilities. GASB 63 also amends certain provisions of GASB Statement No. 34, *Basic Financial Statements — and Management’s Discussion and Analysis* — for State and Local Governments, and related pronouncements to reflect the residual measure in the statement of financial position as net position, rather than net assets.

In March 2012, the Governmental Accounting Standards Board issued GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. Although the Authority is still determining the impact of this pronouncement, it is expected to affect how the refunding of debt and debt issuance cost are recorded. It is effective for periods beginning after December 15, 2012.

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, 2012 and 2011, cash equivalents of approximately \$33.6 million and \$25.9 million, respectively, consisted of money market mutual funds with variable interest rates. 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.

State of Arkansas Safe Drinking Water Revolving Loan Fund Program

Notes to Financial Statements

June 30, 2012 and 2011

Bond Issuance Costs and Premiums

Costs related to issuing bonds and premiums on sales 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 bond issuance costs and premiums.

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: 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.

At June 30, 2012 and 2011, 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.

State of Arkansas Safe Drinking Water Revolving Loan Fund Program

Notes to Financial Statements

June 30, 2012 and 2011

At June 30, 2012 and 2011, the Program had the following investments and maturities:

(In thousands)

| Type | June 30, 2012 | | | | |
|----------------------------|------------------|---------------------|-----------------|-------------|--------------|
| | Fair Value | Maturities in Years | | | |
| | | Less than 1 | 1-5 | 6-10 | More than 10 |
| U. S. Treasury obligations | \$ 5,006 | \$ - | \$ 5,006 | \$ - | \$ - |
| U. S. agencies obligations | 12,998 | 10,000 | 2,998 | - | - |
| Money market mutual funds | <u>33,616</u> | <u>33,616</u> | <u>-</u> | <u>-</u> | <u>-</u> |
| Total | <u>\$ 51,620</u> | <u>\$ 43,616</u> | <u>\$ 8,004</u> | <u>\$ 0</u> | <u>\$ 0</u> |

(In thousands)

| Type | June 30, 2011 | | | | |
|---------------------------|------------------|---------------------|-------------|-------------|--------------|
| | Fair Value | Maturities in Years | | | |
| | | Less than 1 | 1-5 | 6-10 | More than 10 |
| Money market mutual funds | <u>\$ 25,944</u> | <u>\$ 25,944</u> | <u>\$ 0</u> | <u>\$ 0</u> | <u>\$ 0</u> |

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.

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 “AA+” or not rated by Standard & Poor’s and “Aaa” by Moody’s Investment Service, when owned, and its investments in money market mutual funds, or the investments of those funds were rated “AAAm” 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 Mortgage Corporation Discount Note | \$ 5,000 | 10% |
| Federal Home Loan Bank | 5,000 | 10% |
| Federal Farm Credit Bank | 2,998 | 6% |

State of Arkansas Safe Drinking Water Revolving Loan Fund Program

Notes to Financial Statements

June 30, 2012 and 2011

Summary of Carrying Values

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

| <i>(In thousands)</i> | 2012 | 2011 |
|--|------------------|------------------|
| Carrying value | | |
| Investments | \$ <u>51,620</u> | \$ <u>25,944</u> |
| Included in the following statement of net assets captions | | |
| Cash and cash equivalents | \$ 33,616 | \$ 25,944 |
| Investments – current portion | 10,000 | - |
| Investments – restricted | <u>8,004</u> | <u>-</u> |
| | <u>\$ 51,620</u> | <u>\$ 25,944</u> |

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, 2012 and 2011, such loans had a carrying value of approximately \$151.6 million and \$135.6 million, respectively. The loans bear interest at 0.0% to 2.90% and are collateralized by special assessments, by user charges or by 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. As of June 30, 2012 and 2011, the Program cumulatively had funded \$12.2 million in ARRA loans.

Through the years ended June 30, 2012 and 2011, approximately \$210.9 million and \$179.8 million in loans, respectively, had cumulatively been approved for funding. At June 30, 2012 and 2011, approximately \$40.6 million and \$29.7 million, respectively, remained encumbered and awaiting disbursement to loan recipients.

State of Arkansas Safe Drinking Water Revolving Loan Fund Program

Notes to Financial Statements

June 30, 2012 and 2011

Note 4: Bonds Payable

Bonds payable were as follows at June 30:

(In thousands)

| Series | Interest Rate Range | Final Maturity Dates | 2012 |
|------------------|----------------------|----------------------|------------------|
| 2011-C Serial | 3.25% – 5.00% | 6/1/2026 | \$ 24,375 |
| | Unamortized premiums | | <u>3,737</u> |
| | | | <u>\$ 28,112</u> |

Activity in bonds payable for 2012 was as follows:

| <i>(In thousands)</i> | Beginning Balance | Additions | Reductions | Ending Balance | Amount Due within One Year |
|-----------------------|-------------------|------------------|-------------|------------------|----------------------------|
| 2011-C | \$ <u>0</u> | \$ <u>24,375</u> | \$ <u>0</u> | \$ <u>24,375</u> | \$ <u>0</u> |

The principal amount shown above differs from the amount on the statement of net assets due to unamortized premiums of approximately \$3.7 million.

For fiscal year 2011, the Program did not have any bonds payable outstanding.

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

(In thousands)

| | Principal | Interest |
|------------------------------------|------------------|------------------|
| Fiscal Year ending June 30, | | |
| 2013 | \$ - | \$ 1,175 |
| 2014 | 1,000 | 1,175 |
| 2015 | 1,385 | 1,125 |
| 2016 | 1,470 | 1,056 |
| 2017 | 1,565 | 983 |
| 2018 – 2022 | 9,400 | 3,639 |
| 2023 – 2027 | <u>9,555</u> | <u>1,042</u> |
| | 24,375 | 10,195 |
| Unamortized discounts and premiums | <u>3,737</u> | - |
| | <u>\$ 28,112</u> | <u>\$ 10,195</u> |

State of Arkansas Safe Drinking Water Revolving Loan Fund Program

Notes to Financial Statements

June 30, 2012 and 2011

In the current fiscal year, ADFFA issued \$57.0 million in 2011 Revolving Loan Fund Revenue Bonds, Series C (Series 2011 C). The Series 2011 C bond issue is a combined issue between the Program and the State of Arkansas Construction Assistance Revolving Loan Fund Program. This issue offers the two programs the option of the cross collateralization transfers which provides strength and stability in making the debt service payments. The Series 2011 C was rated “AAA” by Standard & Poor’s and Fitch Ratings. The portion of the Series 2011 C bond issue allocated to the Program is \$24.4 million.

Note 5: 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 2012 and 2011, the Program received approximately 71% and 86%, respectively, of total revenue in the form of federal grants. During fiscal year 2012 and 2011, respectively, the Program disbursed \$125,000 and \$10.5 million in ARRA federal funds.

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. Section 1452 of the EPA Federal Guidelines for the Implementation of Drinking Water State Revolving Loan Fund 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.

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, 2012 and 2011, 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, 2012

| <i>(In thousands)</i> | Small System Technical Assistance | Well Head Protection | Capacity Development | State Program Management |
|--|--|---------------------------------|---------------------------------|-------------------------------------|
| Current Assets | | | | |
| Cash and cash equivalents | \$ - | \$ - | \$ - | \$ - |
| Accrued interest receivable | - | - | - | - |
| Accounts receivable – borrowers | - | - | - | - |
| Accounts receivable – EPA | - | 73 | 168 | 134 |
| Investments – current portion | - | - | - | - |
| Total current assets | - | 73 | 168 | 134 |
| Noncurrent Assets | | | | |
| Investments – restricted | - | - | - | - |
| Loans receivable – restricted Construction Northeast Arkansas Public Water Authority | - | - | - | - |
| Other assets | - | - | - | - |
| Total noncurrent assets | - | - | - | - |
| Total assets | - | 73 | 168 | 134 |
| Current Liabilities | | | | |
| Accounts payable | \$ - | \$ 73 | \$ 168 | \$ 134 |
| Accrued interest payable | - | - | - | - |
| Total current liabilities | - | 73 | 168 | 134 |
| Noncurrent Liabilities | | | | |
| Bonds payable, net of unamortized premiums | - | - | - | - |
| Deferred fees | - | - | - | - |
| Total noncurrent liabilities | - | - | - | - |
| Total liabilities | - | 73 | 168 | 134 |
| 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 |
|------------------------------|--------------------------------|-------------------|
| \$ 1,017 | \$ 32,599 | \$ 33,616 |
| 18 | 222 | 240 |
| 133 | 14 | 147 |
| - | - | 375 |
| <u>-</u> | <u>10,000</u> | <u>10,000</u> |
| <u>1,168</u> | <u>42,835</u> | <u>44,378</u> |
| - | 8,004 | 8,004 |
| - | 147,514 | 147,514 |
| 4,120 | - | 4,120 |
| <u>-</u> | <u>181</u> | <u>181</u> |
| <u>4,120</u> | <u>155,699</u> | <u>159,819</u> |
| <u>5,288</u> | <u>198,534</u> | <u>204,197</u> |
| \$ 127 | \$ - | \$ 502 |
| <u>-</u> | <u>98</u> | <u>98</u> |
| <u>127</u> | <u>98</u> | <u>600</u> |
| - | 28,112 | 28,112 |
| <u>2,605</u> | <u>-</u> | <u>2,605</u> |
| <u>2,605</u> | <u>28,112</u> | <u>30,717</u> |
| <u>2,732</u> | <u>28,210</u> | <u>31,317</u> |
| <u>\$ 2,556</u> | <u>\$ 170,324</u> | <u>\$ 172,880</u> |

State of Arkansas Safe Drinking Water Revolving Loan Fund Program

**Combining Statement of Revenues, Expenses and Changes in Net Assets
Year Ended June 30, 2012**

| <i>(In thousands)</i> | Small System Technical Assistance | Well Head Protection | Capacity Development | State Program Management |
|--|--|---------------------------------|---------------------------------|-------------------------------------|
| Operating Revenues | | | | |
| Interest on investments | \$ - | \$ - | \$ - | \$ - |
| Interest on loans | - | - | - | - |
| Financing fees | - | - | - | - |
| Net depreciation of investments | - | - | - | - |
| Total operating revenues | - | - | - | - |
| Operating Expenses | | | | |
| Program administration | - | - | - | - |
| Federal financial assistance | | | | |
| Base federal grant | - | - | - | - |
| American Recovery and Reinvestment Act grant | - | - | - | - |
| Bond interest | - | - | - | - |
| Amortization of bond issuance costs | - | - | - | - |
| Amortization of bond premiums | - | - | - | - |
| Total operating expenses | - | - | - | - |
| Operating Income | - | - | - | - |
| Nonoperating Revenue | | | | |
| Base federal grants | 52 | 525 | 1,390 | 1,074 |
| American Recovery and Reinvestment Act federal grant | - | - | - | - |
| Total nonoperating revenue | 52 | 525 | 1,390 | 1,074 |
| Income Before Transfers In (Out), Net | 52 | 525 | 1,390 | 1,074 |
| Transfers (Out) In, Net | (52) | (525) | (1,390) | (1,074) |
| Change in Net Assets | - | - | - | - |
| Net Assets, Beginning of Year | - | - | - | - |
| Net Assets, End of Year | \$ 0 | \$ 0 | \$ 0 | \$ 0 |

| Fees and Expenses | Revolving Loan Fund | Total |
|------------------------------|--------------------------------|-------------------|
| \$ - | \$ 7 | \$ 7 |
| 83 | 2,888 | 2,971 |
| 1,613 | - | 1,613 |
| <u>-</u> | <u>(2)</u> | <u>(2)</u> |
| <u>1,696</u> | <u>2,893</u> | <u>4,589</u> |
| 160 | - | 160 |
| - | 178 | 178 |
| - | 125 | 125 |
| - | 757 | 757 |
| - | 14 | 14 |
| <u>-</u> | <u>(280)</u> | <u>(280)</u> |
| <u>160</u> | <u>794</u> | <u>954</u> |
| 1,536 | 2,099 | 3,635 |
| (11) | 8,033 | 11,063 |
| <u>-</u> | <u>125</u> | <u>125</u> |
| <u>(11)</u> | <u>8,158</u> | <u>11,188</u> |
| 1,525 | 10,257 | 14,823 |
| <u>(5,024)</u> | <u>7,015</u> | <u>(1,050)</u> |
| (3,499) | 17,272 | 13,773 |
| <u>6,055</u> | <u>153,052</u> | <u>159,107</u> |
| \$ <u>2,556</u> | \$ <u>170,324</u> | \$ <u>172,880</u> |

**State of Arkansas Safe Drinking Water
Revolving Loan Fund Program
Combining Statement of Cash Flows
Year Ended June 30, 2012**

| <i>(In thousands)</i> | Small System Technical Assistance | Well Head Protection | Capacity Development |
|--|--|---------------------------------|---------------------------------|
| Operating Activities | | | |
| Interest received on loans | \$ - | \$ - | \$ - |
| Interest received on investments | - | - | - |
| Loan disbursements | - | - | - |
| Principal repayments on loans | - | - | - |
| Financing fees | - | - | - |
| Federal grant funds expended | - | - | - |
| Cash paid for interest | - | - | - |
| Cash paid for program administration | - | - | - |
| | <hr/> | <hr/> | <hr/> |
| Net cash provided by (used in) operating activities | - | - | - |
| | <hr/> | <hr/> | <hr/> |
| Noncapital Financing Activities | | | |
| Proceeds from bond issuance | - | - | - |
| Cash paid for cost of issuance of long-term debt | - | - | - |
| Transfers (out) in | (132) | (487) | (1,311) |
| Nonoperating grants received | 132 | 487 | 1,311 |
| | <hr/> | <hr/> | <hr/> |
| Net cash provided by (used in) noncapital financing activities | - | - | - |
| | <hr/> | <hr/> | <hr/> |
| Investing Activities | | | |
| Purchase of investments | - | - | - |
| | <hr/> | <hr/> | <hr/> |
| Net cash used in investing activities | - | - | - |
| | <hr/> | <hr/> | <hr/> |
| Increase in Cash and Cash Equivalents | - | - | - |
| Cash and Cash Equivalents, Beginning of Year | - | - | - |
| | <hr/> | <hr/> | <hr/> |
| Cash and Cash Equivalents, End of Year | <u>\$ 0</u> | <u>\$ 0</u> | <u>\$ 0</u> |
| Reconciliation of Operating Activities to Net Cash Provided By (Used In) Operating Activities | | | |
| Operating income | \$ - | \$ - | \$ - |
| Item not providing operating activities cash flows | | | |
| Amortization of bond issuance costs | - | - | - |
| Amortization of bond premiums | - | - | - |
| Amortization of deferred financing fees | - | - | - |
| Net depreciation of investments | - | - | - |
| Changes in | | | |
| Accrued interest receivable | - | - | - |
| Accounts receivable | - | - | - |
| Loans receivable | - | - | - |
| Accounts payable | - | - | - |
| Accrued interest payable | - | - | - |
| | <hr/> | <hr/> | <hr/> |
| Net cash provided by (used in) operating activities | <u>\$ 0</u> | <u>\$ 0</u> | <u>\$ 0</u> |

| State Program Management | Fees and Expense | Revolving Loan Fund | Total |
|--------------------------|------------------|---------------------|--------------------|
| \$ - | \$ 82 | \$ 2,854 | \$ 2,936 |
| - | - | (3) | (3) |
| - | - | (19,954) | (19,954) |
| - | - | 3,948 | 3,948 |
| - | 1,424 | (14) | 1,410 |
| - | - | (303) | (303) |
| - | - | (660) | (660) |
| - | (145) | - | (145) |
| - | 1,361 | (14,132) | (12,771) |
| - | - | 28,393 | 28,393 |
| - | - | (195) | (195) |
| (1,016) | (5,024) | 7,015 | (955) |
| 1,016 | 102 | 8,158 | 11,206 |
| - | (4,922) | 43,371 | 38,449 |
| - | - | (18,006) | (18,006) |
| - | - | (18,006) | (18,006) |
| - | (3,561) | 11,233 | 7,672 |
| - | 4,578 | 21,366 | 25,944 |
| <u>\$ 0</u> | <u>\$ 1,017</u> | <u>\$ 32,599</u> | <u>\$ 33,616</u> |
| \$ - | \$ 1,536 | \$ 2,099 | \$ 3,635 |
| - | - | 14 | 14 |
| - | - | (280) | (280) |
| - | (170) | - | (170) |
| - | - | 2 | 2 |
| - | - | (44) | (44) |
| - | (19) | (15) | (34) |
| - | - | (16,006) | (16,006) |
| - | 14 | - | 14 |
| - | - | 98 | 98 |
| <u>\$ 0</u> | <u>\$ 1,361</u> | <u>\$ (14,132)</u> | <u>\$ (12,771)</u> |