

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

Independent Auditor's Report and Financial Statements

June 30, 2016 and 2015



# State of Arkansas Safe Drinking Water Revolving Loan Fund Program

June 30, 2016 and 2015

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## Independent Auditor's Report

The Commissioners of the Arkansas Natural  
Resources Commission (ANRC)

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

### Report on the Financial Statements

We have audited the accompanying basic financial statements of the State of Arkansas Safe Drinking Water Revolving Loan Fund Program (the Program), which are comprised of statements of net position as of June 30, 2016 and 2015, and the related statements of revenues, expenses and changes in net position and statements of cash flows for the years ended June 30, 2016 and 2015, and the related notes to the basic financial statements, as listed in the table of contents.

### ***Management's Responsibility for the Financial Statements***

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

### ***Auditor's Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

The Commissioners of the Arkansas Natural  
Resources Commission (ANRC)

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

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### ***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Program as of June 30, 2016 and 2015, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

### ***Emphasis of a Matter***

As discussed in *Note 1*, the financial statements of the Program are intended to present the financial position, and the changes in financial position 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, 2016 and 2015, and the changes in its financial position and its cash flows, where applicable, for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

### **Other Matters**

#### ***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis listed in the table of contents be presented to supplement the basic financial statements. Such information, although not part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

The Commissioners of the Arkansas Natural  
Resources Commission (ANRC)

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

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*Supplementary Information*

Our audits were 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 audits 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.

**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated October 28, 2016, on our consideration of the Program's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Program's internal control over financial reporting and compliance.

*BKD, LLP*

Little Rock, Arkansas  
October 28, 2016

**State of Arkansas Safe Drinking Water  
Revolving Loan Fund Program  
Management's Discussion and Analysis  
June 30, 2016 and 2015**

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, 2016, basic financial statements include three required statements: the statement of net position; the statement of revenues, expenses and changes in net position; and the statement of cash flows. Comparative totals as of and for the years ended June 30, 2015 and 2014, are also presented. Although not required, these comparative totals are intended to facilitate an enhanced understanding of the Program's financial position and results of operations for the current fiscal year in comparison to the prior fiscal years. Additional information, following the *Notes to Financial Statements*, includes the combining statement of net position; the combining statement of revenues, expenses and changes in net position; as well as the combining statement of cash flows. These combining statements detail the Revolving Loan Fund, the Fees and Expense Set Aside, the Small System Technical Assistance Set Aside, the Well Head Protection Set Aside, the Capacity Development Set Aside and the State Program Management Set Aside, which comprise the Program.

***Condensed Financial Information – Statements of Net Position***

*(In thousands)*

	<b>2016</b>	<b>2015</b>	<b>2014</b>
Total assets	\$ <u>254,246</u>	\$ <u>247,780</u>	\$ <u>235,375</u>
Current liabilities	2,429	2,431	2,070
Noncurrent liabilities	<u>21,184</u>	<u>23,380</u>	<u>25,594</u>
Total liabilities	<u>23,613</u>	<u>25,811</u>	<u>27,664</u>
Net position – restricted by bond resolution and program requirements	\$ <u><u>230,633</u></u>	\$ <u><u>221,969</u></u>	\$ <u><u>207,711</u></u>

The Program's total assets have continually increased over the past three years. At June 30, 2016, total assets increased \$6.5 million from June 30, 2015, which was primarily attributed to the \$12.7 million increase in investments, which is offset by decreases totaling \$6.3 million in cash and cash equivalents, loan receivable – restricted and account receivable – Environmental Protection Agency (EPA). At June 30, 2015, the Program's total assets increased \$12.4 million from June 30, 2014, which was primarily attributed to an increase of \$33.6 million in investments – current portion and loans receivable – restricted, which is offset by a decrease of \$21.0 million in cash and cash equivalents.

**State of Arkansas Safe Drinking Water  
Revolving Loan Fund Program  
Management's Discussion and Analysis  
June 30, 2016 and 2015**

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

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Loan disbursements	\$ 6,407	\$ 12,083	\$ 13,172
Loan repayments	<u>8,142</u>	<u>7,989</u>	<u>5,715</u>
Net (decrease) increase in loans receivable	\$ <u>(1,735)</u>	\$ <u>4,094</u>	\$ <u>7,457</u>

Grants from the United States Environmental Protection Agency comprised 53%, 80% and 81% of the funding source of the repayable loan disbursements for fiscal years ended June 30, 2016, 2015, and 2014, respectively. The table below reflects the amounts used from each funding source for fiscal years 2016, 2015, and 2014 as follows (in thousands):

	<u>2016</u>	<u>2015</u>	<u>2014</u>
EPA Federal			
Base	\$ 3,374	\$ 9,609	\$ 10,623
Revolving Loan Funds	111	-	-
State Matching	<u>2,922</u>	<u>2,474</u>	<u>2,549</u>
	\$ <u>6,407</u>	\$ <u>12,083</u>	\$ <u>13,172</u>

The Program is using other funding sources to fund repayable loans. According to Arkansas state law, principal forgiveness loans are required to be funded from federal grants, therefore the Program has increased the use of state match funds and the Program's revolving loan funds to fund repayable loans. The Program utilizes the multiple funding sources to meet EPA guidelines and to comply with state law.

The Program maintains liquidity for funding loans. The Program invested excess funds in money market mutual funds and in U.S. agencies obligations from time to time to allow for re-evaluation of the Program's liquidity needs. With the slight increase in interest rates along with the increased cash balances, the Program has structured its investment portfolio with maturities of every six months. Currently, the Program has \$30.0 million in investments which will mature in the fiscal year 2017.

The Program's total liabilities decreased to \$23.6 million at June 30, 2016, from \$25.8 million at June 30, 2015, and from \$27.7 million at June 30, 2014. In fiscal year 2016, the Program had a decline of \$2.2 million in the bonds payable due to the payment of scheduled bond redemptions. The decline of \$1.9 million for fiscal year 2015 was attributed to the scheduled bond redemptions and accounts payable expense accruals.

**State of Arkansas Safe Drinking Water  
Revolving Loan Fund Program  
Management's Discussion and Analysis  
June 30, 2016 and 2015**

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

(In thousands)

	2016	2015	2014
Total interest income	\$ 3,702	\$ 3,594	\$ 3,350
Operating income	<u>1,802</u>	<u>1,691</u>	<u>1,654</u>
Total operating income	<u>5,504</u>	<u>5,285</u>	<u>5,004</u>
Program administration	184	183	173
Federal financial assistance	4,356	1,509	4,775
Total interest on bonds	1,074	1,139	1,187
Total amortization expense	<u>(386)</u>	<u>(410)</u>	<u>(393)</u>
Total operating expenses	<u>5,228</u>	<u>2,421</u>	<u>5,742</u>
Operating income (loss)	276	2,864	(738)
Federal grants	12,399	15,967	20,172
Transfers out, net	<u>(4,011)</u>	<u>(4,573)</u>	<u>(3,346)</u>
Change in net position	8,664	14,258	16,088
Net position			
Beginning of year	<u>221,969</u>	<u>207,711</u>	<u>191,623</u>
End of year	<u>\$ 230,633</u>	<u>\$ 221,969</u>	<u>\$ 207,711</u>

Included in total interest income is interest earned on loans and interest earned on investments, which has increased to \$3.7 million for the year ended June 30, 2016, from \$3.6 million for the year ended June 30, 2015, from \$3.4 million for the year ended June 30, 2014. The primary factors for the increases are the continuous funding of loans at a faster pace than repayments in the Program and the increase in interest earnings. Revenues from investments increased to \$193,000 in the fiscal year 2016. The average yield on cash, cash equivalents and investments for fiscal year 2016 has increased to 0.26%; whereas the average yields for 2015 and 2014 were 0.09% and 0.07%, respectively.

Other income includes financing fee income, which is the 1% servicing fee paid by the borrowers, and the net appreciation (depreciation) in investments. In the current year, the Program had an increase in other income totaling \$111,000 which is primarily attributed to an increase in net appreciation (depreciation) in investments. In the prior year, the Program had an increase in other income of \$37,000 which consists of an increase in financing fee income of \$85,000 which was offset by a decrease of \$48,000 in the net appreciation (depreciation) of investments.



**State of Arkansas Safe Drinking Water  
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Total operating expenses increased to \$5.2 million for the year ended June 30, 2016, from \$2.4 million for the year ended June 30, 2015, from \$5.7 million from the year ended June 30, 2014. The increase of \$2.8 million is attributable to increase in federal financial assistance. In fiscal year 2012, the Program began funding principal forgiveness loans from the Base capitalization grant as required by EPA. Each construction draw is forgiven at the time of the draw. The Program is required by state law to use only federal grant funds to make principal forgiveness loans. For fiscal year 2015, operating expenses declined \$3.3 million which was attributed to a decline in federal financial assistance. For the years ended June 30, 2016 and 2015, the Program has awarded principal forgiveness loans to multiple borrowers and has forgiven \$4.4 million and \$1.5 million, respectively.

For fiscal year 2016, federal grants declined \$3.6 million which correlated with the decline in loan disbursements. For fiscal year 2015, federal grants declined \$4.2 million which correlates to the decline in loan disbursements as previously discussed and federal financial assistance. 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, Arkansas Natural Resources Commission (ANRC) or Arkansas Department of Health (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 Program administration expenses. For the fiscal years 2016 and 2015, the Program's transfers out, net were \$4.0 million and \$4.6 million, respectively. The details of transfers in and out are presented in the following table (in thousands):

	<b>2016</b>	<b>2015</b>	<b>2014</b>
ANRC-state match	\$ 672	\$ 479	\$ 1,274
Department of Health	(4,173)	(4,372)	(3,940)
ANRC-administration	(510)	(680)	(680)
Transfers out, net	\$ (4,011)	\$ (4,573)	\$ (3,346)

The net position of the Program increased \$22.9 million in the past two years. The bond resolutions and the Program restrict all of the net position.

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

**Contact Regarding the Program**

This financial report is designed to provide constituents and business partners with a general overview of the Program's finances and to show the Program's accountability for the funds it administers. Questions about this report and requests for additional financial information should be directed to the ADFA Vice President for Finance and Administration by telephoning 501.682.5900 or by contacting the ANRC Water Development Division Chief at 501.682.1611.

# State of Arkansas Safe Drinking Water Revolving Loan Fund Program

## Statements of Net Position June 30, 2016 and 2015

(In thousands)

	2016	2015
<b>Current Assets</b>		
Cash and cash equivalents	\$ 15,988	\$ 20,159
Accrued interest receivable	310	257
Accounts receivable		
Borrowers	112	114
Environmental Protection Agency	432	858
Investments – current portion	30,030	54,505
Total current assets	46,872	75,893
<b>Noncurrent Assets</b>		
Investments – restricted	37,222	-
Loans receivable – restricted		
Construction	166,361	168,003
Northeast Arkansas Public Water Authority	3,791	3,884
Total noncurrent assets	207,374	171,887
Total assets	254,246	247,780
<b>Current Liabilities</b>		
Accounts payable	536	536
Accrued interest payable	83	90
Bonds payable – current portion	1,810	1,805
Total current liabilities	2,429	2,431
<b>Noncurrent Liabilities</b>		
Bonds payable, net of unamortized premiums	21,184	23,380
Total liabilities	23,613	25,811
<b>Net Position</b>		
Restricted by bond resolution and program requirements	\$ 230,633	\$ 221,969

**State of Arkansas Safe Drinking Water  
Revolving Loan Fund Program**  
**Statements of Revenues, Expenses and Changes in Net Position**  
**Years Ended June 30, 2016 and 2015**

(In thousands)

	<u>2016</u>	<u>2015</u>
<b>Operating Revenues</b>		
Interest on investments	\$ 193	\$ 93
Interest on loans	3,509	3,501
Financing fees	1,732	\$ 1,724
Net appreciation (depreciation) of investments	<u>70</u>	<u>(33)</u>
Total operating revenues	<u>5,504</u>	<u>5,285</u>
<b>Operating Expenses</b>		
Program administration	184	183
Federal financial assistance		
Base federal grants	4,356	1,509
Bond interest	1,074	1,139
Amortization of bond premiums	<u>(386)</u>	<u>(410)</u>
Total operating expenses	<u>5,228</u>	<u>2,421</u>
<b>Operating Income</b>	<u>276</u>	<u>2,864</u>
<b>Nonoperating Revenue</b>		
Base federal grants	<u>12,399</u>	<u>15,967</u>
<b>Income Before Transfers Out, Net</b>	12,675	18,831
<b>Transfers Out, Net</b>	<u>(4,011)</u>	<u>(4,573)</u>
<b>Change in Net Position</b>	8,664	14,258
<b>Net Position, Beginning of Year</b>	<u>221,969</u>	<u>207,711</u>
<b>Net Position, End of Year</b>	<u>\$ 230,633</u>	<u>\$ 221,969</u>

# State of Arkansas Safe Drinking Water Revolving Loan Fund Program

## Statements of Cash Flows Years Ended June 30, 2016 and 2015

(In thousands)

	2016	2015
<b>Operating Activities</b>		
Financing fees received	\$ 1,735	\$ 1,741
Cash paid for program administration	<u>(185)</u>	<u>(181)</u>
Net cash provided by operating activities	<u>1,550</u>	<u>1,560</u>
<b>Noncapital Financing Activities</b>		
Repayment of long term debt	(1,805)	(1,265)
Cash paid for interest	(1,081)	(1,144)
Transfers out	(4,011)	(4,750)
Nonoperating grants received	<u>12,825</u>	<u>16,177</u>
Net cash provided by noncapital financing activities	<u>5,928</u>	<u>9,018</u>
<b>Investing Activities</b>		
Interest received on investments	130	59
Interest received on loans	3,519	3,530
Principal repayments on loans	8,142	7,989
Loan disbursements	(6,407)	(12,083)
Federal grant funds expended	(4,356)	(1,509)
Proceeds from maturities of investments	76,500	51,500
Purchase of investments	<u>(89,177)</u>	<u>(81,036)</u>
Net cash used in investing activities	<u>(11,649)</u>	<u>(31,550)</u>
<b>Decrease in Cash and Cash Equivalents</b>	(4,171)	(20,972)
<b>Cash and Cash Equivalents, Beginning of Year</b>	<u>20,159</u>	<u>41,131</u>
<b>Cash and Cash Equivalents, End of Year</b>	<u>\$ 15,988</u>	<u>\$ 20,159</u>
<b>Reconciliation of Operating Income to Net Cash Provided by Operating Activities</b>		
Operating income	\$ 276	\$ 2,864
Items not requiring (providing) operating activities cash flows		
Interest on investments	(193)	(93)
Interest on loans	(3,509)	(3,501)
Bond interest	1,074	1,139
Amortization of bond premiums	(386)	(410)
Net depreciation (appreciation) of investments	(70)	33
Federal grants expended	4,356	1,509
Changes in		
Accounts receivable – borrowers	2	17
Accounts payable	<u>-</u>	<u>2</u>
Net cash provided by operating activities	<u>\$ 1,550</u>	<u>\$ 1,560</u>

# State of Arkansas Safe Drinking Water Revolving Loan Fund Program

## Notes to Financial Statements

June 30, 2016 and 2015

### 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, 2016 and 2015, were \$138,000 and \$140,000, respectively.

#### ***Use of Estimates***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change relate to the determination of fair values of investments.

#### ***Measurement Focus, Basis of Accounting and Financial Statement Presentation***

The Program is accounted for as an enterprise fund for financial reporting purposes and utilizes the economic resource measurement focus and accrual basis of accounting wherein revenues are recognized when earned and expenses when incurred.

Operating revenues and expenses are distinguished from nonoperating items in the Program's statement of revenues, expenses and changes in net position. Operating revenues and expenses generally result from providing services in connection with the principal ongoing operations. All revenues and expenses not meeting this definition are reported as nonoperating items.

# State of Arkansas Safe Drinking Water Revolving Loan Fund Program

## Notes to Financial Statements

June 30, 2016 and 2015

### ***Recently Issued Accounting Pronouncements***

GASB Statement No. 72, *Fair Value Measurement and Application* (GASB 72): GASB 72 addresses accounting and financial reporting issues related to fair value measurements. The definition of fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. GASB 72 provides guidance for determining a fair value measurement for financial reporting purposes that aligns with the Financial Accounting Standards Board's Topic 820. GASB 72 also provides that all assets meeting the definition of an investment in the Statement should be measured at fair value, unless the Statement provided otherwise. Certain disclosures related to all fair value measurements are required (*See Note 5*). GASB 72 enhances comparability of financial statements among governments by requiring measurement of certain assets and liabilities at fair value using a consistent and more detailed definition of fair value and accepted valuation techniques. GASB 72 also enhances fair value application guidance and related disclosures in order to provide information to financial statement users about the impact of fair value measurements on a government's financial position. GASB 72 is effective for financial statements for fiscal years beginning after June 15, 2015 and any prior periods presented should be restated, including disclosures, if practical. See *Note 5* for disclosures required by GASB 72.

### ***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, 2016 and 2015, cash equivalents of approximately \$16.0 million and \$20.2 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.

### ***Bond Premiums***

Premiums on the sale of bonds are capitalized and are amortized over the term of the bonds using the effective interest method. Early retirement of bonds results in the acceleration of amortization of the premiums.

### ***Net Position Restricted by Bond Resolution and Program Requirements***

Net position restricted by bond resolution and program requirements represents funds restricted due to the specific provisions of the Program.

# State of Arkansas Safe Drinking Water Revolving Loan Fund Program

## Notes to Financial Statements

June 30, 2016 and 2015

### ***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.

### ***Reclassifications***

Certain reclassifications have been made to the fiscal year 2015 financial statements to conform to the fiscal year 2016 financial statement presentation. These reclassifications had no effect on the change in net position.

## **Note 2: Deposits and Investments**

### ***Deposits***

Custodial credit risk is the risk that in the event of a bank failure, the Program's deposits may not be returned to it. The Program's deposit policy for custodial credit risk requires compliance with the provisions of state law and bond indentures.

At June 30, 2016 and 2015, 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, 2016 and 2015

At June 30, 2016 and 2015, the Program had the following investments and maturities:

(In thousands)

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

(In thousands)

Type	June 30, 2015				
	Fair Value	Maturities in Years			
		Less than 1	1-5	6-10	More than 10
U. S. agencies obligations	\$ 54,505	\$ 54,505	\$ -	\$ -	\$ -
Money market mutual funds	<u>20,159</u>	<u>20,159</u>	-	-	-
Total	<u>\$ 74,664</u>	<u>\$ 74,664</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</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 “Aaa” or not rated by Moody’s Investment Service, and rated “AA+” or not rated by Standard & Poor’s and its investments in money market mutual funds, or the investments of those funds were rated “AAA-mf” or “AAA” by Standard & Poor’s and “Aaa-mf” or “Aaa” by Moody’s Investors Service.



# State of Arkansas Safe Drinking Water Revolving Loan Fund Program

## Notes to Financial Statements

June 30, 2016 and 2015

*Concentration of Credit Risk*—The Program places no limit on the amount that may be invested in any one issuer. Investments of the Program (not guaranteed by the U.S. government or considered mutual funds) representing 5% or more of total investments are as follows (in thousands):

Issuer	Fair Value	Percentage
Federal Home Loan Bank	\$ 36,187	54%
Federal Home Loan Mortgage Corporation	25,056	37%
Federal National Mortgage Association	6,009	9%

### Summary of Carrying Values

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

<i>(In thousands)</i>	2016	2015
Carrying value		
Investments	\$ <u>83,240</u>	\$ <u>74,664</u>
Included in the following statement of net position captions		
Cash and cash equivalents	\$ 15,988	\$ 20,159
Investments – current portion	30,030	54,505
Investment – restricted	<u>37,222</u>	<u>-</u>
	\$ <u>83,240</u>	\$ <u>74,664</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, 2016 and 2015, such loans had a carrying value of approximately \$170.2 million and \$171.9 million, respectively. The loans bear interest at 0.0% to 2.90% and are collateralized by special assessments, user charges or sales and use tax bonds issued by the municipalities.

In fiscal year 2010, the Program began funding loans with American Recovery and Reinvestment Act (ARRA) federal funds, along with other funding sources. As of June 30, 2016 and 2015, the Program's outstanding loan balance for ARRA loans totaled \$21.0 million and \$22.0 million, respectively.

# State of Arkansas Safe Drinking Water Revolving Loan Fund Program

## Notes to Financial Statements June 30, 2016 and 2015

Through the years ended June 30, 2016 and 2015, approximately \$228.6 million and \$228.0 million in loans, respectively, had cumulatively been approved for funding. At June 30, 2016 and 2015, approximately \$8.2 million and \$14.1 million, respectively, remained encumbered and awaiting disbursement to loan recipients.

### Note 4: Bonds Payable

Bonds payable were as follows at June 30:

*(In thousands)*

Series	Interest Rate Range	Final Maturity Dates	2016	2015
2011-C Serial	3.25% – 5.00%	6/1/2028	\$ 20,995	\$ 22,800
	Unamortized premiums		<u>1,999</u>	<u>2,385</u>
			<u>\$ 22,994</u>	<u>\$ 25,185</u>

Activity in bonds payable for 2016 was as follows:

*(In thousands)*

	Beginning Balance	Additions	Reductions	Ending Balance	Amount Due within One Year
2011-C	\$ <u>22,800</u>	\$ <u>-</u>	\$ <u>(1,805)</u>	\$ <u>20,995</u>	\$ <u>1,810</u>

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

Activity in bonds payable for 2015 was as follows:

*(In thousands)*

	Beginning Balance	Additions	Reductions	Ending Balance	Amount Due within One Year
2011-C	\$ <u>24,065</u>	\$ <u>-</u>	\$ <u>(1,265)</u>	\$ <u>22,800</u>	\$ <u>1,805</u>

The principal amount shown above differs from the amount on the statement of net position due to unamortized premiums of approximately \$2.4 million.

# State of Arkansas Safe Drinking Water Revolving Loan Fund Program

## Notes to Financial Statements

June 30, 2016 and 2015

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

<i>(In thousands)</i>	<b>Principal</b>	<b>Interest</b>
Fiscal Year ending June 30,		
2017	\$ 1,810	\$ 991
2018	1,765	901
2019	2,205	812
2020	2,065	702
2021	1,985	599
2022 – 2026	9,440	1,550
2027 – 2028	1,725	87
	20,995	5,642
Unamortized premiums	1,999	-
	\$ 22,994	\$ 5,642

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

### **Note 5: Disclosures About Fair Value of Assets and Liabilities**

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

- Level 1**            Quoted prices in active markets for identical assets or liabilities
  
- Level 2**            Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
  
- Level 3**            Unobservable inputs supported by little or no market activity and are significant to the fair value of the assets or liabilities.

# State of Arkansas Safe Drinking Water Revolving Loan Fund Program

## Notes to Financial Statements

June 30, 2016 and 2015

### Recurring Measurements

The following table presents the fair value measurements of assets recognized in the accompanying financial statements measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at June 30, 2016 and 2015:

June 30, 2016				
Fair Value Measurements Using				
Type	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U. S. agency obligations	\$ <u>67,252</u>	\$ _____ -	\$ <u>67,252</u>	\$ _____ -

June 30, 2015				
Fair Value Measurements Using				
Type	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U. S. agencies obligations	\$ <u>54,505</u>	\$ _____ -	\$ <u>54,505</u>	\$ _____ -

Following is a description of the valuation methodologies and inputs used for assets measured at fair value on a recurring basis and recognized in the accompanying financial statements, as well as the general classification of such assets pursuant to the valuation hierarchy. There have been no significant changes in the valuation techniques during the years ended June 30, 2016 or 2015.

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. The Program did not classify any of its investments a Level 1 at June 30, 2016 or June 30, 2015. Level 2 securities include U.S. Government and federal agencies. If quoted market prices are not available, then fair values are estimated by an independent third-party pricing service using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. For these investments, the inputs used by the pricing service to determine fair value may include one, or a combination of observable inputs such as benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data market research publications and are classified within Level 2 of the valuation hierarchy. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy. The Program did not have any Level 3 securities at June 30, 2016 or June 30, 2015.

# State of Arkansas Safe Drinking Water Revolving Loan Fund Program

## Notes to Financial Statements

June 30, 2016 and 2015

### Note 6: Significant Estimates and Concentrations

Accounting principles generally accepted in the United States of America require disclosure of certain significant estimates and current vulnerabilities due to certain concentrations. Those matters include the following:

#### ***Economic Dependency***

The Program is economically dependent upon revenue from the Environmental Protection Agency (EPA). During 2016 and 2015, the Program received approximately 69% and 75%, respectively, of total revenue in the form of federal grants.

#### ***Program Set Asides***

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

Section 1452 of the EPA Federal Guidelines for the Implementation of Drinking Water State Revolving Loan Fund (DWSRF) indicates a state may reserve the right to redirect unused set aside funds as eligible expenditures of the Program. Since the inception of the Program, ANRC, in conjunction with DOH, has redirected approximately \$6.3 million from previous years' capitalization grants as eligible funds for disbursement to loan borrowers.

The Code of Federal Regulations section 40 CFR 3540, regarding the DWSRF, states a state may reserve or "bank" set aside funds at the time of the grant application. The intent is that the authority for a set aside activity from one year can be used in a future year when the amount available in that future year is not enough to accomplish the set aside activity. Each set aside activity has specific eligible costs associated with it. Reserved authority in a set aside activity can only be used for that same set aside activity in the future. For each grant application, the state has to demonstrate to EPA that the funds requested for each set aside activity can be used within a two year period. If this results in the state having additional authority for that activity that they cannot use within the two year period, they can reserve that additional authority for some unspecified future grant. The amount of authority reserved for each set aside activity will be reported in the Intended Use Plan (IUP) for that fiscal year and every succeeding IUP until the authority is used. When the state wants to use the authority that has been reserved, the state must demonstrate to EPA that all of the authority in the future grant and the additional reserved authority can be expended within the two year period. The management of the Program is aware if future federal capitalization grants are not made available, the reserved authority is lost. Since the inception of the Program, DOH has reserved authority of \$7.9 million in the Small System Technical Assistance and the State Program Management Set Asides.

# State of Arkansas Safe Drinking Water Revolving Loan Fund Program

## Notes to Financial Statements

June 30, 2016 and 2015

### **Principal Forgiveness Loans**

In fiscal year 2012, the Program began funding principal forgiveness loans (PF) with Base federal grant funds. EPA required as part of the Base capitalization grant requirements that a percentage of the grant be available as subsidy to eligible borrowers. With the federal fiscal year 2010 and 2011 capitalization grant, at least 30% of the grant would be in the form of forgiveness of principal, negative interest loans or grants. The percentage was changed to be not less than 20%, but not greater than 30% of the federal fiscal year 2012 through 2015 grants. To be eligible to receive subsidy, the borrower must show either:

1. The annual utility rates on 4,000 gallons of water is at least 1.5% of the medium household income for the project area, or
2. At least 51% of the benefiting customers have either low or moderate income as defined by the U. S. Department of Housing and Urban Development Community Development Block Grant Program and the utility rates are at least 1.25% of the medium household income.

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

( In thousands)

Federal Fiscal Year	Base Capitalization Grant Award	PF Minimum Amount	PF Maximum Amount	Program Allocation Amount	Cumulative Disbursements	PF Remaining to Disburse
2010	\$ 20,539	\$ 6,162	\$ 20,539	\$ 6,163	\$ 6,163	\$ -
2011	14,252	4,276	14,252	4,278	4,278	-
2012	13,582	2,716	4,075	2,743	2,743	-
2013	12,743	2,549	3,823	2,625	2,244	381
2014	13,534	2,707	4,660	3,010	1,144	1,866
2015	13,445	2,689	4,033	3,010	<u>95</u>	<u>2,915</u>
Totals					<u>\$ 16,667</u>	<u>\$ 5,162</u>

The Program has targeted the minimum amount from each Base Capitalization grant for principal forgiveness loans. The Program forgives the loans as the construction draws are disbursed. In fiscal year 2016 and 2015, the Program expensed \$4.4 million and \$1.5 million in principal forgiveness loans, respectively.

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

## **Notes to Financial Statements**

**June 30, 2016 and 2015**

### ***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, 2016 and 2015, may be impaired. In the opinion of the management of the Program, there are no significant contingent liabilities relating to compliance with the rules and regulations governing the respective grants; therefore, no provision has been recorded in the accompanying financial statements for such a contingency.

## **Supplementary Information**



**State of Arkansas Safe Drinking Water  
Revolving Loan Fund Program  
Combining Statement of Net Position  
June 30, 2016**

<i>(In thousands)</i>	<b>Small System Technical Assistance</b>	<b>Well Head Protection</b>	<b>Capacity Development</b>	<b>State Program Management</b>
<b>Current Assets</b>				
Cash and cash equivalents	\$ -	\$ -	\$ -	\$ -
Accrued interest receivable	-	-	-	-
Accounts receivable – borrowers	-	-	-	-
Accounts receivable – EPA	-	104	177	115
Investments – current portion	-	-	-	-
Total current assets	<u>-</u>	<u>104</u>	<u>177</u>	<u>115</u>
<b>Noncurrent Assets</b>				
Investments – restricted	-	-	-	-
Loans receivable – restricted				
Construction	-	-	-	-
Northeast Arkansas Public Water Authority	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total noncurrent assets	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total assets	<u>-</u>	<u>104</u>	<u>177</u>	<u>115</u>
<b>Current Liabilities</b>				
Accounts payable	-	104	177	115
Accrued interest payable	-	-	-	-
Bonds payable – current portion	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total current liabilities	<u>-</u>	<u>104</u>	<u>177</u>	<u>115</u>
<b>Noncurrent Liabilities</b>				
Bonds payable, net of unamortized premiums	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total liabilities	<u>-</u>	<u>104</u>	<u>177</u>	<u>115</u>
<b>Net Position</b>				
Restricted by bond resolution and program requirements	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

<b>Fees and Expenses</b>	<b>Revolving Loan Fund</b>	<b>Total</b>
\$ 2,573	\$ 13,415	\$ 15,988
13	297	310
112	-	112
36	-	432
<u>2,003</u>	<u>28,027</u>	<u>30,030</u>
<u>4,737</u>	<u>41,739</u>	<u>46,872</u>
1,000	36,222	37,222
-	166,361	166,361
<u>3,791</u>	<u>-</u>	<u>3,791</u>
<u>4,791</u>	<u>202,583</u>	<u>207,374</u>
<u>9,528</u>	<u>244,322</u>	<u>254,246</u>
138	2	536
-	83	83
<u>-</u>	<u>1,810</u>	<u>1,810</u>
<u>138</u>	<u>1,895</u>	<u>2,429</u>
<u>-</u>	<u>21,184</u>	<u>21,184</u>
<u>138</u>	<u>23,079</u>	<u>23,613</u>
<u>\$ 9,390</u>	<u>\$ 221,243</u>	<u>\$ 230,633</u>

**State of Arkansas Safe Drinking Water  
Revolving Loan Fund Program**  
Combining Statement of Revenues, Expenses and Changes in Net Position  
Year Ended June 30, 2016

<i>(In thousands)</i>	<b>Small System Technical Assistance</b>	<b>Well Head Protection</b>	<b>Capacity Development</b>	<b>State Program Management</b>
<b>Operating Revenues</b>				
Interest on investments	\$ -	\$ -	\$ -	\$ -
Interest on loans	-	-	-	-
Financing fees	-	-	-	-
Net depreciation (appreciation) of investments	-	-	-	-
Total operating revenues	-	-	-	-
<b>Operating Expenses</b>				
Program administration	-	-	-	-
Federal financial assistance	-	-	-	-
Base federal grant	-	-	-	-
Bond interest	-	-	-	-
Amortization of bond premiums	-	-	-	-
Total operating expenses	-	-	-	-
<b>Operating Income</b>	-	-	-	-
<b>Nonoperating Revenue</b>				
Base federal grants	-	717	1,918	1,538
<b>Income Before Transfers (Out) In, Net</b>	-	717	1,918	1,538
<b>Transfers (Out) In, Net</b>	-	(717)	(1,918)	(1,538)
<b>Change in Net Position</b>	-	-	-	-
<b>Net Position, Beginning of Year</b>	-	-	-	-
<b>Net Position, End of Year</b>	\$ -	\$ -	\$ -	\$ -

Fees and Expenses	Revolving Loan Fund	Total
\$ 20	\$ 173	\$ 193
77	3,432	3,509
1,732	-	1,732
<u>(1)</u>	<u>71</u>	<u>70</u>
<u>1,828</u>	<u>3,676</u>	<u>5,504</u>
184	-	184
-	4,356	4,356
-	1,074	1,074
<u>-</u>	<u>(386)</u>	<u>(386)</u>
<u>184</u>	<u>5,044</u>	<u>5,228</u>
<u>1,644</u>	<u>(1,368)</u>	<u>276</u>
<u>495</u>	<u>7,731</u>	<u>12,399</u>
2,139	6,363	12,675
<u>(2,527)</u>	<u>2,689</u>	<u>(4,011)</u>
(388)	9,052	8,664
<u>9,778</u>	<u>212,191</u>	<u>221,969</u>
<u>\$ 9,390</u>	<u>\$ 221,243</u>	<u>\$ 230,633</u>

**State of Arkansas Safe Drinking Water  
Revolving Loan Fund Program  
Combining Statement of Cash Flows  
Year Ended June 30, 2016**

<i>(In thousands)</i>	<b>Small System Technical Assistance</b>	<b>Well Head Protection</b>	<b>Capacity Development</b>
<b>Operating Activities</b>			
Financing fees received	\$ -	\$ -	\$ -
Cash paid for program administration	-	-	-
Net cash provided by operating activities	-	-	-
<b>Noncapital Financing Activities</b>			
Repayment of long term debt	-	-	-
Cash paid for interest	-	-	-
Transfers (out) in	-	(700)	(1,930)
Nonoperating grants received	-	700	1,930
Net cash (used in) provided by noncapital financing activities	-	-	-
<b>Investing Activities</b>			
Interest received on investments	-	-	-
Interest received on loans	-	-	-
Principal repayments on loans	-	-	-
Loan disbursements	-	-	-
Federal grant funds expended	-	-	-
Proceed from maturities of investments	-	-	-
Purchase of investments	-	-	-
Net cash provided by (used in) investing activities	-	-	-
<b>Increase (Decrease) in Cash and Cash Equivalents</b>	-	-	-
<b>Cash and Cash Equivalents, Beginning of Year</b>	-	-	-
<b>Cash and Cash Equivalents, End of Year</b>	\$ -	\$ -	\$ -
<b>Reconciliation of Operating Income to Net Cash Provided By Operating Activities</b>			
Operating income	\$ -	\$ -	\$ -
Items not requiring (providing) operating activities cash flows:			
Interest on loans	-	-	-
Interest on investments	-	-	-
Bond interest	-	-	-
Amortization of bond premiums	-	-	-
Net depreciation (appreciation) of investments	-	-	-
Federal grants expended	-	-	-
Changes in			
Accounts receivable – borrowers	-	-	-
Accounts payable	-	-	-
Net cash provided by operating activities	\$ -	\$ -	\$ -

<b>State Program Management</b>	<b>Fees and Expense</b>	<b>Revolving Loan Fund</b>	<b>Total</b>
\$ -	\$ 1,735	\$ -	\$ 1,735
-	(187)	2	(185)
-	<u>1,548</u>	<u>2</u>	<u>1,550</u>
-	-	(1,805)	(1,805)
-	-	(1,081)	(1,081)
(1,543)	(2,527)	2,689	(4,011)
<u>1,543</u>	<u>921</u>	<u>7,731</u>	<u>12,825</u>
-	<u>(1,606)</u>	<u>7,534</u>	<u>5,928</u>
-	12	118	130
-	78	3,441	3,519
-	93	8,049	8,142
-	-	(6,407)	(6,407)
-	-	(4,356)	(4,356)
-	4,500	72,000	76,500
-	<u>(3,005)</u>	<u>(86,172)</u>	<u>(89,177)</u>
-	<u>1,678</u>	<u>(13,327)</u>	<u>(11,649)</u>
-	1,620	(5,791)	(4,171)
-	<u>953</u>	<u>19,206</u>	<u>20,159</u>
<u>\$ -</u>	<u>\$ 2,573</u>	<u>\$ 13,415</u>	<u>\$ 15,988</u>
\$ -	\$ 1,644	\$ (1,368)	\$ 276
-	(77)	(3,432)	(3,509)
-	(20)	(173)	(193)
-	-	1,074	1,074
-	-	(386)	(386)
-	1	(71)	(70)
-	-	4,356	4,356
-	2	-	2
-	<u>(2)</u>	<u>2</u>	<u>-</u>
<u>\$ -</u>	<u>\$ 1,548</u>	<u>\$ 2</u>	<u>\$ 1,550</u>