

**STATE OF ARKANSAS CONSTRUCTION ASSISTANCE
REVOLVING LOAN FUND PROGRAM**

June 30, 2018 and 2017

**Combined Financial Statements
And
Supplementary Information**

With

Independent Auditor's Report



FROST, PLLC
Certified Public Accountants

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Independent Auditor's Report

Commissioners of the Arkansas Natural
Resources Commission

Board of Directors
Arkansas Development Finance Authority
Little Rock, Arkansas

Report on the Combined Financial Statements

We have audited the accompanying combined financial statements of the State of Arkansas Construction Assistance Revolving Loan Fund Program, which comprise the combined statement of net position as of June 30, 2018, and the related combined statements of revenues, expenses and changes in net position, and cash flows for the year then ended and the related notes to the combined financial statements.

Management's Responsibility for the Combined Financial Statements

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the combined 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 combined 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 combined financial statements.

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

Opinions

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of the State of Arkansas Construction Assistance Revolving Loan Fund Program as of June 30, 2018, and the changes in its financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1.a., the accompanying combined financial statements present only the State of Arkansas Construction Assistance Revolving Loan Fund Program and do not purport to, and do not, present fairly the financial position of the State of Arkansas as of June 30, 2018, and the changes in its financial position and its cash flows for the year 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 information on pages 4 through 9 be presented to supplement the basic combined financial statements. Such information, although not a part of the basic combined 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 combined 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 combined financial statements, and other knowledge we obtained during our audits of the basic combined 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.

Other Information

Our audit was conducted for the purpose of forming an opinion on the combined financial statements that collectively comprise the State of Arkansas Construction Assistance Revolving Loan Fund Program's basic combined financial statements. The schedule of expenditures of federal awards, as required by the audit requirements of Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles and Audit Requirements for Federal Awards*, is presented for purposes of additional analysis and is not a required part of the basic combined financial statements.

The supplementary information on pages 25 through 27 and the schedule of expenditures of federal awards on page 34 are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic combined financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic combined 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 combined financial statements or to the basic combined financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information and the schedule of expenditures of federal awards are fairly stated in all material respects in relation to the basic combined 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 31, 2018, on our consideration of the State of Arkansas Construction Assistance Revolving Loan Fund Program's internal control over financial reporting and on 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 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 State of Arkansas Construction Assistance Revolving Loan Fund Program's internal control over financial reporting and compliance.

Other Matter

The combined financial statements of the State of Arkansas Construction Assistance Revolving Loan Fund Program for the year ended June 30, 2017 were audited by another auditor who expressed an unmodified opinion on those statements on October 31, 2017.

Frost, PLLC

Certified Public Accountants

Little Rock, Arkansas
October 31, 2018

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Management's Discussion and Analysis

For the Years Ended June 30, 2018 and 2017

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 State of Arkansas Construction Assistance Revolving Loan Fund Program (the "Program"). Readers are encouraged to consider the information presented in conjunction with the combined financial statements and notes as a whole, which follow this section of the report.

Discussion of Combined Financial Statements

The June 30, 2018 basic combined financial statements include three required statements: The combined statement of net position; the combined statement of revenues, expenses and changes in net position; and the combined statement of cash flows. Comparative totals as of and for the years ended June 30, 2017 and 2016 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 Combined 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 and the Fees and Expenses Fund, which comprise the Program.

Condensed Financial Information – Combined Statements of Net Position

	<u>2018</u>	<u>2017</u>	<u>2016</u>
<i>(In thousands)</i>			
Total assets and deferred outflow of resources	\$ 413,000	\$ 408,829	\$ 397,078
Liabilities			
Current liabilities	3,247	2,654	2,710
Noncurrent liabilities	<u>21,978</u>	<u>25,325</u>	<u>28,140</u>
Total liabilities	<u>25,225</u>	<u>27,979</u>	<u>30,850</u>
Net position			
Restricted by bond resolution and program requirements	<u>\$ 387,775</u>	<u>\$ 380,850</u>	<u>\$ 366,228</u>

The Program's total assets have increased over the past three years. At June 30, 2018, the total assets increased \$4.2 million as compared to June 30, 2017, which is primarily attributable to the increase of \$42.4 million in cash and cash equivalents and loan receivable - restricted, which is offset by the decline of \$38.3 million in total investments. At June 30, 2017, the total assets increased \$11.8 million as compared to June 30, 2016, which is primarily attributable to the increase of \$40.6 million in cash and cash equivalents and loan receivable - restricted, which is offset by the decline of \$29.1 million in total investments.

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Management's Discussion and Analysis (cont.)

For the Years Ended June 30, 2018 and 2017

The following table reports loan activity for each year:

	<u>2018</u>	<u>2017</u>	<u>2016</u>
<i>(In thousands)</i>			
Loan disbursements	\$ 32,056	\$ 29,511	\$ 24,055
Loan repayments	<u>18,849</u>	<u>23,416</u>	<u>14,411</u>
Net increase in loans receivable	<u>\$ 13,207</u>	<u>\$ 6,095</u>	<u>\$ 9,644</u>

The following table reflects the disbursement of funds to new and existing loan borrowers:

	<u>2018</u>	<u>2017</u>	<u>2016</u>
<i>(In thousands)</i>			
New loans	\$ 63,150	\$ 94,175	\$ 10,200
Loan disbursements - new loans	3,058	13,170	982
Existing loans	\$ 150,875	\$ 56,000	\$ 76,350
Loan disbursements - existing loans	28,998	16,341	23,073

The Program continually made loans from Environmental Protection Agency ("EPA") federal grant funds, prepayment funds, state matching funds and revolving Program funds. The Program received federal funds in the form of an annual capitalization grant (Base). In the current fiscal year, the Program has closed four new loans committing \$63.2 million of Program and grant funds of which \$60.1 million is still to be funded. The Program utilized \$30.3 million of \$32.1 million disbursed in revolving Program funds. In fiscal year 2018, the Program disbursed the \$1.7 million of Federal fiscal year 2017 state matching funds to fund loans which was available for disbursement in fiscal year 2017. Per EPA guidelines and Arkansas Natural Resources Commission ("ANRC") policy, all state match funds must be matched with federal dollars on or prior to the receipt of the federal funds and ANRC has chosen to fund loans with state match funds prior to utilizing the federal capitalization grant. The 2009 Issue Prepayment Funds (Prepayments) fluctuate based upon the loan payoffs. The Program's general bond resolution allows prepayment funds to be used to make new loans within 90 days of receipt, pay principal and interest at debt service or pay principal and interest on called bonds. The Prepayments used to fund loans in fiscal years 2018 and 2017 were from current and prior year loan payoffs. In the prior fiscal year, the Program had approved several new loans that have been partially funded, but the Program had several funding sources available to meet all future funding requirements. The Program utilized \$16.3 million of the total \$29.5 million disbursed in the revolving Program funds. The Program has available \$4.7 million of the Federal Fiscal Year 2016 grant to utilize for additional subsidy and repayable loans.

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Management's Discussion and Analysis (cont.)

For the Years Ended June 30, 2018 and 2017

The table below reflects the amounts used from each funding source for fiscal years 2018, 2017 and 2016:

	<u>2018</u>	<u>2017</u>	<u>2016</u>
<i>(In thousands)</i>			
EPA federal base	\$ -	\$ 7,486	\$ 12,546
State matching funds	1,732	-	2,049
2009 issue prepayment funds	57	5,701	290
Revolving Program funds	<u>30,267</u>	<u>16,324</u>	<u>9,170</u>
	<u>\$ 32,056</u>	<u>\$ 29,511</u>	<u>\$ 24,055</u>

Also, the Program utilized its cash within the Program as an additional funding source, essentially revolving the assets. The Federal fiscal year 2018 Base grant has been approved by the EPA in the amount of \$12.6 million and will be available in October 2018.

The Program's total liabilities decreased to \$25.2 million at June 30, 2018 from \$28.0 million at June 30, 2017, from \$30.9 million at June 30, 2016. In fiscal year 2018, the Program's decline in total liabilities was primarily attributable to the payment of scheduled principal payments on Revolving Loan Fund Series 2011 C ("2011 C Issue") of \$2.3 million. In fiscal year 2017, the Program paid scheduled principal payments of \$2.4 million, which attributed to the decline. The 2011 C Issue matures in 2028.

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Management's Discussion and Analysis (cont.)

For the Years Ended June 30, 2018 and 2017

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

	<u>2018</u>	<u>2017</u>	<u>2016</u>
<i>(In thousands)</i>			
Operating revenues			
Total interest income	\$ 6,272	\$ 5,361	\$ 4,797
Other	<u>2,199</u>	<u>1,808</u>	<u>2,181</u>
Total operating revenues	<u>8,471</u>	<u>7,169</u>	<u>6,978</u>
Operating expenses			
Total interest on bonds and notes	1,187	1,307	1,592
Total amortization expense	(427)	(470)	(587)
Federal financial assistance	469	1,210	3
Administrative expenses	<u>258</u>	<u>254</u>	<u>247</u>
Total operating expenses	<u>1,487</u>	<u>2,301</u>	<u>1,255</u>
Operating income	6,984	4,868	5,723
Base federal grants	766	9,131	12,852
Transfers (out) in, net	<u>(825)</u>	<u>623</u>	<u>(840)</u>
Changes in net position	6,925	14,622	17,735
Net position - beginning of year	<u>380,850</u>	<u>366,228</u>	<u>348,493</u>
Net position - end of year	<u>\$ 387,775</u>	<u>\$ 380,850</u>	<u>\$ 366,228</u>

Total operating revenues have increased over the past three years. In the current fiscal year, the Program had increases of \$1.4 million in interest on investments, financing fee income and net depreciation on investments, which is offset by a decline in interest on loans of \$134,000. The Program monitors cash and investment yields and the cash needs of the Program to ensure liquidity and to maximize investment options. To help increase interest on investments, the Program utilized the Money Management Trust Fund (“MMTF”), an internal investment pool administered by the State of Arkansas. The funds are available within one business days’ notice and offer a higher rate of return. The net depreciation on investments is an adjustment in the market value of the Program’s investments. In the prior fiscal year, the Program’s interest on investments and financing fee income increased \$708,000, which is offset by the decline in interest on loans and net depreciation of investments of \$517,000. Interest on loans has declined over the past three years. Interest on loans decreased \$134,000 in fiscal year 2018 and \$70,000 during fiscal year 2017. Financing fee income, which represents the 1% financing fee paid by the borrowers, has increased over the past three years. Financing fee income increased

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Management's Discussion and Analysis (cont.)

For the Years Ended June 30, 2018 and 2017

\$78,000 and \$74,000 during fiscal years 2018 and 2017, respectively. The Program received \$3.8 million and \$7.7 million in loan prepayments during fiscal years 2018 and 2017, respectively. Loans in repayment are paying on a declining loan balance which effects interest on loans. The Program is still making new loans, but the total loan interest paid by new borrowers is less than the total interest paid by the older borrowers and the Program has restructured the terms on a few older loans. The Program has seen a decline in loan activity over the past few years due to the economy, increased loan prepayment rate, the interest rate environment and the regulations placed on the Program by governing agencies. The average return on loans was 1.56%, 1.72% and 1.79% for the fiscal years ended June 30, 2018, 2017 and 2016, respectively.

Interest on investments was \$2.4 million, \$1.3 million and \$690,000 for fiscal years ended June 30, 2018, 2017 and 2016, respectively. The Program maintains liquidity to fund projects as needed. The Program invested excess funds in U. S. agency obligations at higher yields than current money market mutual fund rates. The Program's investment portfolio is structured with maturities every six months to ensure availability of funds, if needed, and to capitalize on higher long term yields. The Program's long term investments mature in September 2019. Another investment option the Program utilized is the MMTF, which had a yield of 2.3% at fiscal year-end. The Program has \$80.2 million invested in the MMTF, which is reported as a part of cash and cash equivalents. The average return on cash, cash equivalents and investments was 1.28%, 0.63% and 0.28% for the fiscal years ended June 30, 2018, 2017 and 2016, respectively.

Total operating expenses declined \$814,000 in fiscal year 2018 which was primarily attributable to the decline in federal financial assistance and interest on bonds and notes. Total operating expenses increased \$1.0 million in fiscal year 2017, which is primarily attributed to the increase of federal financial assistance, and the decline in interest on bond and notes. Federal financial assistance fluctuates with the volume of principal forgiveness loans available for funding and the rate at which the borrowers request reimbursement. During fiscal years 2018 and 2017, the Program forgave principal of \$469,000 and \$1.2 million, respectively. The Program's interest on bonds and notes decreased \$120,000 and \$285,000 during fiscal years 2018 and 2017, respectively, which correlated to the decrease in bonds payable. Program administration expenses totaled \$258,000, \$254,000 and \$247,000 for the fiscal years ended June 30, 2018, 2017 and 2016, respectively. These expenses included amounts paid for audit expense, trustee fees, legal fees, membership fees to national water related authorities and the administrative fee paid to the Arkansas Development Finance Authority ("ADFA").

Federal grant revenue declined \$8.4 million in fiscal year 2018. The Program decided to allocate the maximum amount allowed of the 2012 through 2017 base federal grants as additional subsidy loans which was approved by EPA, which have not been funded, but reserved for future projects. Base federal grants guidelines allow for the funding of forgiveness of principal, repayable loans and the reimbursement of expenses of the Program. This change allows more funds to be utilized as principal forgiveness loans. Currently, the Program has \$5.5 million in committed principal forgiveness loans of the \$12.8 million allowed by EPA guidelines and ANRC's approved policy for 2012 through 2017 grant year. The Program has \$7.3 million in federal funds still available to be allocated for future principal forgiveness loans. Base federal grants revenue declined \$3.7 million in the prior fiscal year. The Program has expended part of the fiscal year 2015 grant totaling \$5.0 million and \$3.7 million of the fiscal year 2016 grant. The loans of the Program have approximately a two to five-year construction period in which many existing loans are being funded. The Program receives federal grant revenue for reimbursement of the Program's expenses.

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Management's Discussion and Analysis (cont.)

For the Years Ended June 30, 2018 and 2017

Information regarding when base federal grant awards were expended for construction draws and principal forgiveness loans is as follows:

<u>Federal Award Year</u>	<u>Beginning</u>	<u>Amount Expended In</u>		
	<u>Balance</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>
		<i>(In thousands)</i>		
2014	\$ 8,798	\$ -	\$ -	\$ 8,798
2015	8,752	-	5,002	3,750
2016	8,380	469	3,694	-
2017	<u>8,315</u>	<u>-</u>	<u>-</u>	<u>-</u>
	<u>\$ 34,245</u>	<u>\$ 469</u>	<u>\$ 8,696</u>	<u>\$ 12,548</u>

Transfers in and out are comprised of transfers to or from other state programs or agencies. In the current fiscal year, the Program had transfers out of \$825,000 to ANRC for administrating the Program. In the prior fiscal year, the Program received transfers in of \$1.6 million from the ANRC Water, Waste Disposal and Pollution Abatement Facilities General Obligation Bond Fund Program to fund state match, which is offset by transfers out of \$990,000 to ANRC for administrative expenses of the Program. The funding source for the administrative expenses is the 4% set aside of the EPA base capitalization grant along with other funds deposited into the Fees and Expenses Fund.

The net position of the Program increased \$21.5 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 bondholders, 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.

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Combined Statements of Net Position

June 30, 2018 and 2017

(In Thousands)

<u>Assets</u>	<u>2018</u>	<u>2017</u>
Current assets		
Cash and cash equivalents	\$ 122,313	\$ 93,085
Accrued interest receivable		
Investments	319	230
Loans	157	208
Accounts receivable		
Borrowers	99	123
EPA	166	104
Current portion of investments - restricted	<u>31,915</u>	<u>30,150</u>
Total current assets	<u>154,969</u>	<u>123,900</u>
Noncurrent assets		
Investments - restricted	3,201	43,306
Loans receivable - restricted		
Construction loans	254,343	241,136
Wetlands Mitigation	<u>487</u>	<u>487</u>
Total noncurrent assets	<u>258,031</u>	<u>284,929</u>
Total assets	<u>413,000</u>	<u>408,829</u>
<u>Liabilities and Net Position</u>		
Current liabilities		
Accounts payable	237	209
Accrued interest payable	90	100
Current portion of bonds payable	<u>2,920</u>	<u>2,345</u>
Total current liabilities	3,247	2,654
Noncurrent liabilities		
Bonds payable, net of unamortized premiums and current portion	<u>21,978</u>	<u>25,325</u>
Total liabilities	<u>25,225</u>	<u>27,979</u>
Net position		
Restricted by bond resolution and Program requirements	<u>\$ 387,775</u>	<u>\$ 380,850</u>

The accompanying notes are an integral part of these combined financial statements.

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Combined Statements of Revenues, Expenses and Changes in Net Position

For the Years Ended June 30, 2018 and 2017

(In Thousands)

	<u>2018</u>	<u>2017</u>
Operating revenues		
Interest on investments	\$ 2,369	\$ 1,324
Interest on loans	3,903	4,037
Financing fee income	2,443	2,365
Net depreciation of investments	<u>(244)</u>	<u>(557)</u>
Total operating revenues	<u>8,471</u>	<u>7,169</u>
Operating expenses		
Program administration	258	254
Federal financial assistance - base	469	1,210
Bond interest	1,187	1,307
Amortization of bond premiums	<u>(427)</u>	<u>(470)</u>
Total operating expenses	<u>1,487</u>	<u>2,301</u>
Operating income	6,984	4,868
Nonoperating income		
Base federal grants	<u>766</u>	<u>9,131</u>
Income before transfers (out) in, net	7,750	13,999
Transfers (out) in, net	<u>(825)</u>	<u>623</u>
Changes in net position	6,925	14,622
Net position - beginning of year	<u>380,850</u>	<u>366,228</u>
Net position - end of year	<u>\$ 387,775</u>	<u>\$ 380,850</u>

The accompanying notes are an integral part of these combined financial statements.

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Combined Statements of Cash Flows

For the Years Ended June 30, 2018 and 2017

(In Thousands)

	<u>2018</u>	<u>2017</u>
Cash flows from operating activities		
Financing fee income received	\$ 2,467	\$ 2,384
Cash paid for program administration	<u>(230)</u>	<u>(240)</u>
Net cash provided by operating activities	<u>2,237</u>	<u>2,144</u>
Cash flows from noncapital financing activities		
Repayments of bonds payable	(2,345)	(2,405)
Cash paid for interest	(1,197)	(1,317)
Nonoperating grants received	704	9,027
Transfers (out) in	<u>(825)</u>	<u>623</u>
Net cash provided (used) by noncapital financing activities	<u>(3,663)</u>	<u>5,928</u>
Cash flows from investing activities		
Interest received on investments	2,280	1,236
Interest received on loans	3,954	4,057
Purchases of investments	(3,104)	(41,456)
Proceeds from maturities of investments	41,200	69,948
Loan disbursements	(32,056)	(29,511)
Principal repayments on loans	18,849	23,416
Federal grant funds expended	<u>(469)</u>	<u>(1,210)</u>
Net cash provided by investing activities	<u>30,654</u>	<u>26,480</u>
Net increase in cash and cash equivalents	29,228	34,552
Cash and cash equivalents - beginning of year	<u>93,085</u>	<u>58,533</u>
Cash and cash equivalents - end of year	<u>\$ 122,313</u>	<u>\$ 93,085</u>

	<u>2018</u>	<u>2017</u>
Reconciliation of changes in net assets to net cash provided by operating activities		
Operating income	\$ 6,984	\$ 4,868
Adjustments to reconcile operating income of changes in net assets to net cash provided by operating activities		
Interest on investments	(2,369)	(1,324)
Interest on loans	(3,903)	(4,037)
Bond interest	1,187	1,307
Amortization of bond premiums	(427)	(470)
Net depreciation of investments	244	557
Federal grants expended	469	1,210
Changes in operating assets and liabilities		
Accounts receivable - borrowers	24	19
Accounts payable	<u>28</u>	<u>14</u>
Net cash provided by operating activities	<u>\$ 2,237</u>	<u>\$ 2,144</u>

The accompanying notes are an integral part of these combined financial statements.

**STATE OF ARKANSAS CONSTRUCTION ASSISTANCE
REVOLVING LOAN FUND PROGRAM**

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Notes to Combined Financial Statements

June 30, 2018 and 2017

1. Nature of Operations and Summary of Significant Accounting Policies

- a. **Nature of operations and reporting entity** – The State of Arkansas Construction Assistance Revolving Loan Fund Program (the “Program”), an enterprise fund of the State of Arkansas, was created pursuant to the 1987 Amendments (P.L. 100-4) to the “Clean Water Act” (P.L.92-500) to provide a perpetual fund for financing the construction of wastewater treatment facilities for municipalities and other public entities. The Program is to be capitalized with federal grants from the U.S. Environmental Protection Agency (“EPA”) and state matching funds on a ratio of five federal dollars to one state dollar.

As of July 2001, the Arkansas Natural Resources Commission (“ANRC”), formerly known as Arkansas Soil and Water Conservation Commission, became the lead agency for the Program (previously led by Arkansas Department of Environmental Quality). As lead agency, ANRC is responsible for performing technical project reviews, monitoring construction and coordinating the total management of the Program. Act 1243 of 2006 authorized the name change to ANRC, which has not had an impact on the Program. Arkansas Development Finance Authority (“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 combined financial statements and procuring audit services. ADFA is reimbursed for the Program’s administration costs through a calculation based on loans outstanding in accordance with the interagency agreement. The amounts incurred to ADFA for administration costs were approximately \$205,000 and \$196,000 for the years ended June 30, 2018 and 2017, respectively, and are included in the Program’s administration expenses.

The Arkansas Agriculture Water Quality Loan Program (“AAWQLP”) is accounted for within the Program. Under the AAWQLP, the ANRC establishes noninterest-bearing cash accounts with financial institutions. In fiscal 2007, an agreement was established with AgriBank in which AAWQLP would purchase a noninterest-bearing bond in conjunction with loans made by AgriBank under the AAWQLP guidelines. Loans are originated by the financial institution or AgriBank to the farmers or property owners that provide for the installation of water quality, antipollution equipment. Interest income normally earned on these balances at the financial institutions or on the bond is used to reduce the interest rates applicable to the loans obtained by the farmers or other property owners. ANRC has established a program contribution limit to AAWQLP in the amount of \$25 million. As of June 30, 2018 and 2017, the AAWQLP had \$6.5 million and \$6.8 million, respectively, in deposits and investments with various financial institutions.

- b. **Use of estimates** – The preparation of combined 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 combined 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.

**STATE OF ARKANSAS CONSTRUCTION ASSISTANCE
REVOLVING LOAN FUND PROGRAM**

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Notes to Combined Financial Statements

June 30, 2018 and 2017

1. **Nature of Operations and Summary of Significant Accounting Policies (cont.)**

- c. **Measurement focus and basis of accounting** – 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 non-operating 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 non-operating items.

- d. **Recently issued accounting pronouncements** – Governmental Accounting Standards Board (“GASB”) Statement No. 85, “Omnibus 2017.” This statement addresses practice issues that have been identified during implementation and application of certain GASB standards and addresses a variety of topics, including issues related to blending component units, goodwill, fair value measurement and postemployment benefits. The requirements of this statement are effective for reporting periods beginning after June 15, 2017. During fiscal 2018, the Program implemented GASB Statement No. 85, which did not have a material effect on its combined financial statements.

GASB Statement No. 86, “Certain Debt Extinguishment Issues.” This statement improves consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources – resources other than the proceeds of refunding debt – are placed in an irrevocable trust for the sole purpose of extinguishing debt. This statement is effective for periods beginning after June 15, 2017, with earlier application encouraged. During fiscal 2018, the Program implemented GASB Statement No. 86, which did not have a material effect on its combined financial statements.

GASB Statement No. 87, “Leases.” This statement establishes a new single model for lease accounting based on the principle that leases represent the financing of the right to use an underlying asset. The effective date is for periods beginning after December 15, 2019. The Program has not yet determined the potential impact, if any, that this statement could have on its combined financial statements.

GASB Statement No. 88, “Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements.” This statement improves the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. It also clarifies which liabilities governments should include when disclosing information related to debt. This statement is effective for periods beginning after June 15, 2018. The Program has not yet determined the potential impact, if any, this statement could have on its combined financial statements.

**STATE OF ARKANSAS CONSTRUCTION ASSISTANCE
REVOLVING LOAN FUND PROGRAM**

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Notes to Combined Financial Statements

June 30, 2018 and 2017

1. **Nature of Operations and Summary of Significant Accounting Policies (cont.)**

GASB Statement No. 89, "Accounting for Interest Cost Incurred before the End of a Construction Period." This statement enhances the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and simplifies accounting for interest cost incurred before the end of a construction period. This statement requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. This statement supersedes paragraphs 5 through 22 of GASB Statement No. 62, "Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements." This statement is effective for periods beginning after December 15, 2019. The requirements of this statement should be applied prospectively. The Program has not yet determined the potential impact, if any, this statement could have on its combined financial statements.

- e. **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, 2018 and 2017, cash equivalents of approximately \$122.3 million and \$93.1 million, respectively, consisted primarily of money market mutual funds with variable interest rates and an internal governmental investment pool administered by the State of Arkansas.

Included in cash equivalents on the Program's statement of net position is the Fees and Expenses Fund with a balance of approximately \$11.4 million and \$9.6 million at June 30, 2018 and 2017, respectively. This fund contains fees charged on loans of the Program as allowed by the EPA, federal grant administration set aside funds and interest earnings of the fund. These funds may be used at the discretion of the ANRC to fund expenses of the Program.

- f. **Investments** – Investments are carried at fair value. Fair value is determined using quoted market prices. Investment income is related to interest earned on cash and investments.
- g. **Bond premiums** – 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 premiums.
- h. **Finance fees** – The Program receives a 1% annual financing fee from the borrowers.
- i. **Net position restricted by bond resolution, enabling legislation and program requirements** – Net position restricted by bond resolution, enabling legislation and program requirements represents funds restricted due to the specific provisions of the Program.
- j. **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.

**STATE OF ARKANSAS CONSTRUCTION ASSISTANCE
REVOLVING LOAN FUND PROGRAM**

Notes to Combined Financial Statements

June 30, 2018 and 2017

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. Deposits are collateralized for those amounts exceeding federal depository insurance, typically with obligations of the U.S. Treasury, U.S. agencies or instrumentalities or municipal bonds having an aggregate market value at least equal to 105% of the amount of the deposits as directed in the State Board of Finance Cash Management of Funds Rule 2012-A.

At June 30, 2018 and 2017, \$1.7 million and \$1.5 million, respectively, of the Program's deposits (and carrying value) of \$3.6 million were exposed to custodial credit risk as follows:

	<u>2018</u>	<u>2017</u>
<i>(In thousands)</i>		
Uninsured and collateral held by Pledging Financial Institution agent in the Program's name	<u>\$ 1,723</u>	<u>\$ 1,467</u>

Investments

Arkansas statutes and the Program's General Resolution authorizes 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 CONSTRUCTION ASSISTANCE
REVOLVING LOAN FUND PROGRAM**

Notes to Combined Financial Statements

June 30, 2018 and 2017

2. Deposits and Investments (cont.)

At June 30, 2018 and 2017, the Program had the following investments and maturities:

<i>(In thousands)</i>	Maturities in Years				<u>Total</u>
	<u>Less than 1</u>	<u>1 - 5</u>	<u>6 - 10</u>	<u>More than 10</u>	
<u>June 30, 2018</u>					
U.S. agencies obligations	\$ 31,915	\$ 3,201	\$ -	\$ -	\$ 35,116
Money market mutual funds	38,492	-	-	-	38,492
State Treasurer Money Management Trust Fund	80,204	-	-	-	80,204
	\$ 150,611	\$ 3,201	\$ -	\$ -	\$ 153,812
<u>June 30, 2017</u>					
U.S. agencies obligations	\$ 30,151	\$ 43,306	\$ -	\$ -	\$ 73,457
Money market mutual funds	58,327	-	-	-	58,327
State Treasurer Money Management Trust Fund	31,132	-	-	-	31,132
	\$ 119,610	\$ 43,306	\$ -	\$ -	\$ 162,916

- a. **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. The Program has also begun investing in an internal governmental investment pool administrated by the State of Arkansas. The Program may request withdrawal of its funds with one business days’ notice.
- b. **Credit risk** – Credit risk is the risk 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 Investors Service and rated “AA+” or not rated by Standard & Poor’s and its investments in money market mutual funds or investments of those funds were rated “AAAm” or “AAA” by Standard & Poor’s and “Aaa-mf” or “Aaa” by Moody’s Investors Service.
- c. **Custodial credit risk** – For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Program will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. The Program’s investment in mutual funds is not classified by custodial credit risk category, as they are not evidenced by securities in physical or book entry form.

**STATE OF ARKANSAS CONSTRUCTION ASSISTANCE
REVOLVING LOAN FUND PROGRAM**

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Notes to Combined Financial Statements

June 30, 2018 and 2017

2. Deposits and Investments (cont.)

- d. **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:

<u>Issuer</u>	2018		2017	
	<u>Fair Value</u>	<u>Percentage</u>	<u>Fair Value</u>	<u>Percentage</u>
<i>(In thousands)</i>				
Money Management Trust Fund	\$ 80,204	52%	\$ -	0%
Federal Home Loan Mortgage Corporation	19,245	13%	39,270	24%
Federal Home Loan Bank	-	0%	22,012	14%
Federal National Mortgage Association	8,984	6%	8,989	6%

Summary of Carrying Values

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

	<u>2018</u>	<u>2017</u>
<i>(In thousands)</i>		
Carrying value		
Deposits	\$ 3,617	\$ 3,625
Investments	153,812	162,916
	\$ 157,429	\$ 166,541

Included in the following combined statements of net position captions:

	<u>2018</u>	<u>2017</u>
<i>(In thousands)</i>		
Cash and cash equivalents	\$ 122,313	\$ 93,085
Investments		
Current portion	31,915	30,150
Restricted	3,201	43,306
	\$ 157,429	\$ 166,541

**STATE OF ARKANSAS CONSTRUCTION ASSISTANCE
REVOLVING LOAN FUND PROGRAM**

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Notes to Combined Financial Statements

June 30, 2018 and 2017

3. Loans Receivable

The Program originates loans with Arkansas municipalities, sewer improvement districts, and water facilities boards for financing the construction of wastewater treatment facilities. The loans are payable in semiannual installments. At June 30, 2018 and 2017, such loans had a carrying value of approximately \$254.8 million and \$241.6 million, respectively, of which approximately \$49.4 million and \$55.2 million, respectively, are for projects still under construction. The loans bear interest ranging from 0.00% to 3.75% and are collateralized by special assessments, user charges or sales and use tax bonds issued by the municipalities, sewer improvement districts and water facilities board.

In fiscal 2010, the Program funded loans with American Recovery and Reinvestment Act (“ARRA”) federal funds. As of June 30, 2018, the Program’s current loan balance of ARRA loans was \$3.9 million which was funded with ARRA and other program funds.

During the years ended June 30, 2018 and 2017, \$797.3 million and \$734.1 million, respectively, in cumulative loans had been approved for funding. At June 30, 2018 and 2017, \$125.4 million and \$94.5 million, respectively, remained encumbered and awaiting disbursement to loan recipients.

4. Bonds Payable

Bonds payable consist of the following:

<u>Series</u>	<u>Interest Rate Range</u>	<u>Final Maturity Dates</u>	<u>2018</u>	<u>2017</u>
			<u>(In thousands)</u>	
2011-C Serial	3.25% - 5.00%	June 1, 2028	\$ 23,140	\$ 25,485
	Unamortized premiums		<u>1,758</u>	<u>2,185</u>
			<u>\$ 24,898</u>	<u>\$ 27,670</u>

Activity in bonds payable consists of the following:

<u>(In thousands)</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Amount Due within One Year</u>
<u>June 30, 2018</u>					
2011-C	<u>\$ 25,485</u>	<u>\$ -</u>	<u>\$ (2,345)</u>	<u>\$ 23,140</u>	<u>\$ 2,920</u>
<u>June 30, 2017</u>					
2011-C	<u>\$ 27,890</u>	<u>\$ -</u>	<u>\$ (2,405)</u>	<u>\$ 25,485</u>	<u>\$ 2,345</u>

**STATE OF ARKANSAS CONSTRUCTION ASSISTANCE
REVOLVING LOAN FUND PROGRAM**

Notes to Combined Financial Statements

June 30, 2018 and 2017

4. Bonds Payable (cont.)

The principal amount shown above differs from the amount on the combined statements of net position due to unamortized premiums of approximately \$1.8 million and \$2.2 million at June 30, 2018 and 2017, respectively.

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

<u>Fiscal Year Ended June 30,</u>	<u>Principal</u>	<u>Interest</u>
	<i>(In thousands)</i>	
2019	\$ 2,920	\$ 1,079
2020	2,745	933
2021	2,640	796
2022	2,525	664
2023	2,530	538
2024 - 2028	9,780	972
	23,140	4,982
Unamortized premiums	1,758	-
	\$ 24,898	\$ 4,982

The Program has not had new bond issuances in fiscal 2018 nor 2017.

5. Fair Value of Financial Instruments

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 I** – Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.
- **Level II** – Quoted prices in markets that are not active or inputs, which are observable, either directly or indirectly, for substantially the full term of the asset or liability.
- **Level III** – Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

**STATE OF ARKANSAS CONSTRUCTION ASSISTANCE
REVOLVING LOAN FUND PROGRAM**

Notes to Combined Financial Statements

June 30, 2018 and 2017

5. Fair Value of Financial Instruments (cont.)

Recurring Measurements

The following table presents the fair value measurements of assets recognized in the accompanying combined 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:

	<u>Fair Value</u>	<u>Quoted Prices in Active Markets for Identical Assets (Level I)</u>	<u>Significant Other Observable Inputs (Level II)</u>	<u>Significant Unobservable Inputs (Level III)</u>
<i>(In thousands)</i>				
<u>June 30, 2018</u>				
U.S. agencies obligations	\$ 35,116	\$ -	\$ 32,221	\$ 2,895
State Treasurer Money Management Trust Fund	80,204	-	80,204	-
	\$ 115,320	\$ -	\$ 112,425	\$ 2,895
 <u>June 30, 2017</u>				
U.S. agencies obligations	\$ 73,457	\$ -	\$ 70,272	\$ 3,185
State Treasurer Money Management Trust Fund	31,132	-	31,132	-
	\$ 104,589	\$ -	\$ 101,404	\$ 3,185

The 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 combined 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, 2018 or 2017.

Where quoted market prices are available in an active market, securities are classified within Level I of the valuation hierarchy. The Program's investments were not classified as Level I securities at June 30, 2018 or 2017. Level II securities include U.S. government and federal agencies and the State Treasurer Money Management Trust Fund ("MMTF") and U.S. Treasury notes. 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

Notes to Combined Financial Statements

June 30, 2018 and 2017

5. **Fair Value of Financial Instruments (cont.)**

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. The fair value of MMTF is calculated by the internal governmental investment pool. All these types of Program's investments are classified within Level II of the valuation hierarchy. In certain cases where Level I or Level II inputs are not available, securities are classified within Level III of the hierarchy. The Program has classified one investment as Level III. The Program has a relationship with AgriBank in where the Program purchases a Federal Farm Credit Bank bond. This investment is marketed only to the Program and the Program has concluded the fair market value to be equal to the par amount.

The fair value amounts in the previous table do not reflect all investments included in the amounts presented in the combined statements of net position. GASB Statement No. 72, "Fair Value Measurement and Application," provides certain exceptions for money market mutual funds.

6. **Concentrations**

Economic Dependency

The Program's federal revenue is dependent upon the amount of annual federal grants awarded and the amounts available for disbursement. The amount awarded varies from year to year and does have an impact on the Program's total revenue. For the years ended June 30, 2018 and 2017, the Program received 8% and 56%, respectively, of total revenue in the form of federal grants. As of June 30, 2018 and 2017, the Program has \$8.4 million of the Federal Fiscal Years 2017 and 2016 grants remaining to disburse.

Principal Forgiveness Loans

In the fiscal 2013, the Program began funding principal forgiveness ("PF") loans with base federal capitalization grant funds. The 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 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 2012 through 2014 and the 2016 grants. The 2015 grant conditions allowed up to 30% of the capitalization grant may be provided as additional subsidization consistent with the provisions provided under Water Resources Reform and Development Act ("WRRDA"). States are not required to provide a minimum amount of additional subsidization for this grant. However, the above requirement only applies to the portion of the total base capitalization grant federal appropriation that exceeds \$1 billion.

The amendments to the Clean Water Act, also known as the WRRDA signed into law by President Obama on June 10, 2014, provide an additional 30% available for additional subsidization (WRRDA Sec. 603 (i)) and applies to amounts received by the state in capitalization grants for fiscal years beginning after September 30, 2014.

**STATE OF ARKANSAS CONSTRUCTION ASSISTANCE
REVOLVING LOAN FUND PROGRAM**

Notes to Combined Financial Statements

June 30, 2018 and 2017

6. Concentrations (cont.)

1. The current utility rates or proposed utility rates for 4,000 gallons of water on an annual basis are at least 1.5% of the Median Household Income (“MHI”) for the project area.
2. The customers who benefit from a project are at least 51% have either low or moderate income, as defined by the U.S. Department of Housing and Urban Developments’ Community Block Grant Program; and have 1.25% of MHI.
3. If the population trend (2010 census compared to 1990 census) has declined at least 20% (the 2010 population is at least 20% lower than the 1990 population) then the ratio used drops to 1.25% of the MHI for the project area.
4. If the unemployment figures (average of last three five-year American Community Survey Census Bureau numbers) are 250% higher than the state’s unemployment figures then the ratio used drops to 1.25% of the MHI for the project area.

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

Federal Fiscal Year	Grant Award <u>Amount</u>	PF Minimum <u>Amount</u>	PF Maximum <u>Amount</u>	Cumulative Disbursements	PF Amount Remaining to Fund
<i>(In thousands)</i>					
2010	\$ 13,328	\$ 1,996	\$ 6,654	\$ 1,996	\$ -
2011	9,657	895	2,983	1,694	1,289
2012	9,239	513	770	350	420
2013	8,722	411	616	-	616
2014	9,165	499	748	-	748
2015	9,117	-	2,735	-	2,735
2016	8,729	873	3,491	-	3,491
2017	8,661	866	3,464	-	3,464
				<u>\$ 4,040</u>	<u>\$ 12,763</u>

The Program has allocated the minimum amount for 2010 and the maximum amounts for the 2011 to the 2017 base capitalization grants as shown above. The 2015 base capitalization grant does not have a minimum amount, but the maximum amount is \$2.7 million. The Program has the option to spend up to the maximum amount for each base capitalization grant.

The Program forgives the loans as the construction draws are disbursed. In fiscal 2018 and 2017, \$469,000 and \$1.2 million, respectively, in PF loans were expensed.

**STATE OF ARKANSAS CONSTRUCTION ASSISTANCE
REVOLVING LOAN FUND PROGRAM**

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Notes to Combined Financial Statements

June 30, 2018 and 2017

6. **Concentrations (cont.)**

Contingencies

The Program is partially capitalized by state funds and a federal grant program, which are governed by various rules and regulations of the grantor agency. Costs charged to the respective grant programs are subject to audit and adjustments by the grantor agency; therefore, to the extent the Program has not complied with the rules and regulations governing the grants, refunds of any money received may be required and the collectibility of any related receivable 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 combined financial statements for such a contingency.

7. **Subsequent Events Evaluation Date**

The Program evaluated the events and transactions subsequent to its June 30, 2018 statement of net position date and determined there were no significant events to report through October 31, 2018, which is the date the Program issued its combined financial statements.

**STATE OF ARKANSAS CONSTRUCTION ASSISTANCE
REVOLVING LOAN FUND PROGRAM**

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Combining Statement of Net Position

June 30, 2018

(In Thousands)

<u>Assets</u>	<u>Revolving Loan Fund</u>	<u>Fees and Expenses</u>	<u>Total</u>
Current assets			
Cash and cash equivalents	\$ 110,919	\$ 11,394	\$ 122,313
Accrued interest receivable			
Investments	301	18	319
Loans	157	-	157
Accounts receivable			
Borrowers	-	99	99
EPA	-	166	166
Current portion of investments - restricted	<u>31,915</u>	<u>-</u>	<u>31,915</u>
Total current assets	<u>143,292</u>	<u>11,677</u>	<u>154,969</u>
Noncurrent assets			
Investments - restricted	3,201	-	3,201
Loans receivable - restricted			
Construction loans	254,343	-	254,343
Wetlands Mitigation	<u>153</u>	<u>334</u>	<u>487</u>
Total noncurrent assets	<u>257,697</u>	<u>334</u>	<u>258,031</u>
Total assets	<u>400,989</u>	<u>12,011</u>	<u>413,000</u>
<u>Liabilities and Net Position</u>			
Current liabilities			
Accounts payable	32	205	237
Accrued interest payable	90	-	90
Current portion of bonds payable	<u>2,920</u>	<u>-</u>	<u>2,920</u>
Total current liabilities	3,042	205	3,247
Noncurrent liabilities			
Bonds payable, net of unamortized premiums and current portion	<u>21,978</u>	<u>-</u>	<u>21,978</u>
Total liabilities	<u>25,020</u>	<u>205</u>	<u>25,225</u>
Net position			
Restricted by bond resolution and Program requirements	<u>\$ 375,969</u>	<u>\$ 11,806</u>	<u>\$ 387,775</u>

See independent auditor's report.

**STATE OF ARKANSAS CONSTRUCTION ASSISTANCE
REVOLVING LOAN FUND PROGRAM**

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Combining Statement of Revenues, Expenses and Changes in Net Position

For the Year Ended June 30, 2018

(In Thousands)

	<u>Revolving Loan Fund</u>	<u>Fees and Expenses</u>	<u>Total</u>
Operating revenues			
Interest on investments	\$ 2,204	\$ 165	\$ 2,369
Interest on loans	3,903	-	3,903
Financing fee income	-	2,443	2,443
Net depreciation of investments	<u>(247)</u>	<u>3</u>	<u>(244)</u>
Total operating revenues	<u>5,860</u>	<u>2,611</u>	<u>8,471</u>
Operating expenses			
Program administration	-	258	258
Federal financial assistance - base	469	-	469
Bond interest	1,187	-	1,187
Amortization of bond premiums	<u>(427)</u>	<u>-</u>	<u>(427)</u>
Total operating expenses	<u>1,229</u>	<u>258</u>	<u>1,487</u>
Operating income	4,631	2,353	6,984
Nonoperating income			
Base federal grants	<u>469</u>	<u>297</u>	<u>766</u>
Income before transfers out, net	5,100	2,650	7,750
Transfers out, net	<u>-</u>	<u>(825)</u>	<u>(825)</u>
Changes in net position	5,100	1,825	6,925
Net position - beginning of year	<u>370,869</u>	<u>9,981</u>	<u>380,850</u>
Net position - end of year	<u>\$ 375,969</u>	<u>\$ 11,806</u>	<u>\$ 387,775</u>

See independent auditor's report.

**STATE OF ARKANSAS CONSTRUCTION ASSISTANCE
REVOLVING LOAN FUND PROGRAM**

Combining Statement of Cash Flows

For the Year Ended June 30, 2018

(In Thousands)

	<u>Revolving Loan Fund</u>	<u>Fees and Expenses</u>	<u>Total</u>
Cash flows from operating activities			
Financing fee income received	\$ -	\$ 2,467	\$ 2,467
Cash paid for program administration	<u>19</u>	<u>(249)</u>	<u>(230)</u>
Net cash provided by operating activities	<u>19</u>	<u>2,218</u>	<u>2,237</u>
 Cash flows from noncapital financing activities			
Repayments of bonds payable	(2,345)	-	(2,345)
Cash paid for interest	(1,197)	-	(1,197)
Nonoperating grants received	468	236	704
Transfers out	<u>-</u>	<u>(825)</u>	<u>(825)</u>
Net cash used by noncapital financing activities	<u>(3,074)</u>	<u>(589)</u>	<u>(3,663)</u>
 Cash flows from investing activities			
Interest received on investments	2,131	149	2,280
Interest received on loans	3,954	-	3,954
Purchases of investments	(3,104)	-	(3,104)
Proceeds from maturities of investments	41,198	2	41,200
Loan disbursements	(32,056)	-	(32,056)
Principal repayments on loans	18,849	-	18,849
Federal grant funds expended	<u>(469)</u>	<u>-</u>	<u>(469)</u>
Net cash provided by investing activities	<u>30,503</u>	<u>151</u>	<u>30,654</u>
 Net increase in cash and cash equivalents	27,448	1,780	29,228
 Cash and cash equivalents - beginning of year	<u>83,471</u>	<u>9,614</u>	<u>93,085</u>
 Cash and cash equivalents - end of year	<u>\$ 110,919</u>	<u>\$ 11,394</u>	<u>\$ 122,313</u>

	<u>Revolving Loan Fund</u>	<u>Fees and Expenses</u>	<u>Total</u>
Reconciliation of changes in net assets to net cash provided by operating activities			
Operating income	\$ 4,631	\$ 2,353	\$ 6,984
Adjustments to reconcile operating income of changes in net assets to net cash provided by operating activities			
Interest on investments	(2,204)	(165)	(2,369)
Interest on loans	(3,903)	-	(3,903)
Bond interest	1,187	-	1,187
Amortization of bond premiums	(427)	-	(427)
Net (appreciation) depreciation of investments	247	(3)	244
Federal grants expended	469	-	469
Changes in operating assets and liabilities			
Accounts receivable - borrowers	-	24	24
Accounts payable	<u>19</u>	<u>9</u>	<u>28</u>
Net cash provided by operating activities	<u>\$ 19</u>	<u>\$ 2,218</u>	<u>\$ 2,237</u>

See independent auditor's report.

**Independent Auditor’s Report on Internal Control Over Financial Reporting
and on Compliance and Other Matters Based on an Audit of Financial
Statements Performed in Accordance With *Government Auditing Standards***

Commissioners of the Arkansas Natural
Resources Commission

Board of Directors
Arkansas Development Finance Authority
Little Rock, Arkansas

We have audited, 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, the combined financial statements of the State of Arkansas Construction Assistance Revolving Loan Fund Program (the “Program”), which comprise the combined statement of net position as of June 30, 2018, and the related combined statements of revenues, expenses and changes in net position, and cash flows for the year then ended, and the related notes to the basic combined financial statements, and have issued our report thereon dated October 31, 2018, which contained an “emphasis of matter” paragraph regarding a definition of the reporting entity.

Internal Control Over Financial Reporting

In planning and performing our audit of the combined financial statements, we considered the Program’s internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the combined financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Program’s internal control. Accordingly, we do not express an opinion on the effectiveness of the Program’s internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity’s combined financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Program's combined financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Frost, PLLC

Certified Public Accountants

Little Rock, Arkansas
October 31, 2018

**Independent Auditor's Report on Compliance for Each
Major Federal Program and Report on Internal Control
Over Compliance in Accordance With the Uniform Guidance**

Commissioners of the Arkansas Natural
Resources Commission

Board of Directors
Arkansas Development Finance Authority
Little Rock, Arkansas

Report on Compliance for Each Major Federal Program

We have audited the State of Arkansas Construction Assistance Revolving Loan Fund Program's (the "Program") compliance with the types of compliance requirements described in the U.S. Office of Management and Budget *Compliance Supplement* that could have a direct and material effect on each of the Program's major federal programs for the year ended June 30, 2018. The Program's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts and grants applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the Program's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. Code of Federal Regulations ("CFR") Part 200, *Uniform Administrative Requirements, Cost Principles and Audit Requirements for Federal Awards* ("Uniform Guidance"). Those standards and Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Program's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the Program's compliance.

Opinion on Each Major Federal Program

In our opinion, the Program complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2018.

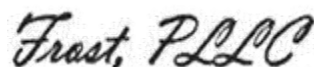
Report on Internal Control Over Compliance

Management of the Program is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Program's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program as a basis for designing auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Program's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.



Certified Public Accountants

Little Rock, Arkansas
October 31, 2018

STATE OF ARKANSAS CONSTRUCTION ASSISTANCE
REVOLVING LOAN FUND PROGRAM

Schedule of Findings and Questioned Costs

For the Year Ended June 30, 2018

Section I – Summary of Auditor’s Results

Combined Financial Statements

Type of auditor’s report issued: Unmodified

Internal control over financial reporting:

Material weaknesses identified? Yes No

Significant deficiencies identified? Yes None Reported

Noncompliance material to combined financial statements noted? Yes No

Federal Awards

Internal control over major programs:

Material weaknesses identified? Yes No

Significant deficiencies identified? Yes None Reported

Type of auditor’s report issued on compliance for major federal programs. Unmodified

Are any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)? Yes No

Identification of major federal programs:

CFDA Number(s) and Name of Federal Program or Cluster

Capitalization Grants for Clean Water State Revolving Funds 66.458

Dollar threshold used to distinguish between type A and type B programs: \$ 750,000

Auditee qualified as a low-risk auditee? Yes No

**STATE OF ARKANSAS CONSTRUCTION ASSISTANCE
REVOLVING LOAN FUND PROGRAM**

Summary Schedule of Prior Audit Findings

For the Year Ended June 30, 2018

<u>Reference Number</u>	<u>Summary of Finding</u>	<u>Status</u>
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No matters are reportable

**STATE OF ARKANSAS CONSTRUCTION ASSISTANCE
REVOLVING LOAN FUND PROGRAM**

Schedule of Expenditures of Federal Awards

For the Year Ended June 30, 2018

<u>Federal Grantor/Pass-Through Grantor Program or Cluster Title</u>	<u>Federal CFDA Number</u>	<u>Provided to Subrecipients</u>	<u>Total Federal Expenditures</u>
U.S. Environmental Protection Agency/Capitalization Grants for Clean Water State Revolving Funds	66.458	<u>\$ 468,849</u>	<u>\$ 766,427</u>

The accompanying notes are an integral part of the schedule of expenditures of federal awards.

**STATE OF ARKANSAS CONSTRUCTION ASSISTANCE
REVOLVING LOAN FUND PROGRAM**

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Notes to Schedule of Expenditures of Federal Awards

For the Year Ended June 30, 2018

1. The accompanying schedule of expenditures of federal awards (“SEFA”) includes the federal award activity of the State of Arkansas Construction Assistance Revolving Loan Fund Program (the “Program”) under programs of the federal government for the year ended June 30, 2018. The information in the SEFA is presented in accordance with the requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (“Uniform Guidance”). Because the SEFA presents only a selected portion of the operations of the Program, it is not intended to and does not present the net position, changes in net position or cash flows of the Program.
2. Expenditures reported on the SEFA are reported on the accrual basis of accounting. Such expenditures are recognized following, as applicable, the cost principles in U.S. Office of Management and Budget A-110 or contained in the Uniform Guidance, wherein certain types of expenditures are not allowable or are limited as to reimbursement. The Program has elected not to use the 10% de minimis indirect cost rate allowed under the Uniform Guidance.
3. Expenditures reflected in CFDA 66.458, Capitalization Grants for the Clean Water State Revolving Funds, include loans to municipalities and other public entities for construction of water treatment facilities. The funding source for these loans includes federal grant funds, state match funds, bond funds and revolving Program funds. The funds are disbursed to the subrecipients after expenses have been incurred as forgiveness of principal and repayable loans. The Program’s outstanding loan receivable balance from subrecipients was \$254.8 million for the year ended June 30, 2018. Total federal disbursements totaled \$469,000 during fiscal year 2018, which represented funding for principal forgiveness loans. For the year ended June 30, 2018, the Program received \$298,000 in federal funds for administrative costs.