

**Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas**

Accountants' Report and Financial Statements

June 30, 2003 and 2002



**Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas
June 30, 2003 and 2002**

Contents

Management's Discussion and Analysis	i
Independent Accountants' Report on Financial Statements and Supplementary Information	1
Financial Statements	
Statements of Net Assets	2
Statements of Revenues, Expenses and Changes in Net Assets	3
Statements of Cash Flows	4
Notes to Financial Statements	6
Supplementary Information	
Combining Statement of Net Assets.....	24
Combining Statement of Revenues, Expenses and Changes in Net Assets	25

Arkansas Development Finance Authority, A Component Unit of The State of Arkansas

Management Discussion and Analysis

This discussion and analysis is designed to assist the reader in focusing on significant issues and activities and to identify any significant changes in the financial position of the Arkansas Development Finance Authority (“ADFA” or the “Authority”). Readers are encouraged to consider the information presented in conjunction with the financial statements and notes as a whole.

Understanding the Financial Statements

The basic financial statements include three required statements: the statement of net assets, the statement of revenues, expenses and changes in net assets and the statement of cash flows. These statements are presented for all of ADFA’s programs in the Combined Statements. Comparative totals as of and for the year ended June 30, 2002 are also presented. Although not required, these comparative totals are intended to facilitate an enhanced understanding of the Authority’s financial position and results of operations for the current fiscal year in comparison to the prior fiscal year. ADFA has eight programs presented as supplementary information following the Notes to the Combined Statements: Single Family Housing Programs; Federal Housing Programs; Multi-Family Programs; Economic Development Bond Guaranty Program; State and Health Facilities Program; Other Economic Development Programs; Tobacco Bond Program and General Fund Programs. A description of each of these programs is included in *Note 1* of the Notes to the Combined Statements.

Condensed Statements of Net Assets

<i>In thousands</i>	2003	2002
Capital assets	\$ 233	\$ 225
Other assets	<u>1,686,705</u>	<u>1,692,646</u>
Total assets	<u>1,686,938</u>	<u>1,692,871</u>
Current liabilities	184,878	134,671
Noncurrent liabilities	<u>1,314,447</u>	<u>1,385,380</u>
Total liabilities	<u>1,499,325</u>	<u>1,520,051</u>
Net assets		
Restricted by bond resolution	126,245	122,801
Invested in capital assets	233	225
Unrestricted	<u>61,135</u>	<u>49,794</u>
Total net assets	<u>\$ 187,613</u>	<u>\$ 172,820</u>

Arkansas Development Finance Authority, A Component Unit of The State of Arkansas Management Discussion and Analysis

At June 30, 2003, ADFA's total assets of \$1.7 billion consisted primarily of investments of \$1.1 billion, loans receivable, net of \$337.1 million and cash of \$184.1 million. Total assets decreased \$5.9 million or four tenths of one percent (0.4%), attributed to the Authority's net bond activity (discussed below), offset by an increase in General Fund assets of \$32.0 million, related to the warehousing of Single Family mortgage-backed securities and by a decline of \$25.3 million in assets for the Tobacco Bond Program, representing construction draws.

ADFA's total liabilities, primarily bonds and notes payable, net, decreased \$20.7 million, or one percent (1%), to \$1.5 billion as of June 30, 2003. The decrease is primarily attributed to the Authority's new bond issuance of \$306.2 million during the fiscal year not exceeding total bond redemptions of \$320.6 million. Included in these amounts is activity related to the single family convertible note program, which the Authority uses to preserve single family tax-exempt bond issuance authority. The Authority borrowed \$164.8 million and redeemed \$101.3 million using the convertible note program during the current year.

Condensed Statements of Revenues, Expenses and Changes in Net Assets

<i>In thousands</i>	2003	2002
Total investment income	\$ 121,119	\$ 117,289
Other income	183	40
Total operating revenues	121,302	117,329
Total interest on bonds and notes	79,118	85,147
Total amortization	2,105	1,458
Administrative expenses	15,704	17,535
Total operating expenses	96,927	104,140
Operating income	24,375	13,189
Federal grants	13,079	11,266
Transfers out	(22,661)	(2,876)
Change in net assets	14,793	21,579
Net assets		
Beginning of year	172,820	151,241
End of year	\$ 187,613	\$ 172,820

Operating income and federal grants totaled \$37.5 million and \$24.5 million for fiscal years ended June 30, 2003 and June 30, 2002, respectively. The change of \$13.0 million is primarily attributed to the net appreciation in the fair value of investments.

The overall financial position and results of operations of ADFA have improved.

Arkansas Development Finance Authority, A Component Unit of The State of Arkansas Management Discussion and Analysis

Other Financial Highlights

Loans and direct financing lease income decreased \$2.2 million, to \$22.5 million for year ending June 30, 2003. The average interest yield changed slightly to 4.9% at June 30, 2003 compared with 4.8% at June 30, 2002. Revenues from interest and dividends were \$55.8 million and \$60.1 million for fiscal years ending June 30, 2003 and June 30, 2002, respectively. The average return on cash, cash equivalents and investments declined to 4.7% at June 30, 2003 compared with 4.9% at June 30, 2002.

The Authority has certain bond issues whereby interest earnings on cash, cash equivalents and investments are deferred until the borrower uses the funds for debt service. These are primarily in the State and Health Facilities Program, Economic Development Bond Guaranty Program and the Tobacco Bond Program. The total interest deferred for these programs was \$2.8 million and \$4.6 million for June 30, 2003 and 2002, respectively. The yield above does not include these deferred amounts.

In September 2002, the Authority's general fund began warehousing mortgage-backed securities created by its Single Family Housing Programs. The securities are funded directly by the general fund or by borrowing from the Federal Home Loan Bank. The Authority will use bond proceeds to purchase the securities from the general fund. Interest income and interest expense recorded by the general fund related to warehousing was approximately \$1.2 million and \$.3 million, respectively, for the current year.

The average interest expense on bonds and notes payable was 5.6% at June 30, 2003, compared with 5.8% at June 30, 2002. The decrease is to due bond refundings and redemptions, some of which is attributed to the high mortgage loan prepayments experienced during the year.

Total administrative expenses decreased \$1.8 million during fiscal year ending June 30, 2003. This is primarily attributed to the provision for loan losses and other administrative expenses. The provision for loan losses decreased \$2.2 million. In fiscal year 2003, the provision related to loans in the Economic Development Bond Guaranty Program was four thousand dollars compared with \$1.6 million in fiscal year 2002.

During September 2001, ADFA issued \$60 million of revenue bonds associated with the State of Arkansas' Tobacco Settlement Revenue ("TSR") to be used by participating colleges to construct and equip three facilities outlined by the Arkansas Tobacco Settlement Funds Act of 2000. The bonds are to be repaid from the first \$5 million of annual TSRs paid to the State. Once the construction of the three facilities is completed and the bond proceeds and related interest are expended, the financial statements will only reflect the bonds payable, not the corresponding assets, as the resulting buildings will reside on the financial statements of the respective colleges. Interest income on the bond proceeds is recorded as deposits against financing arrangements on the statement of net assets while interest expense is recorded as such on the statement of revenues, expenses and changes in net assets. For the fiscal years ending June 30, 2003 and June 30, 2002, \$2.9 million and \$2.3 million, respectively, were recorded as interest expense for this bond issue.

Arkansas Development Finance Authority, A Component Unit of The State of Arkansas

Management Discussion and Analysis

ADFA has maintained an Issuer Credit Rating (“ICR”) from Standard & Poors of ‘A’ since it was received in 1999. Subsequent to year end, Standards & Poors affirmed the ‘A’ rating and upgraded the outlook to “positive” from “stable”. Changes in state and federal legislation statutes can play a role in ADFA achieving its goals and objectives.

The Authority also administers the Bond Guaranty Fund, created by Act 505. The fund currently has a rating of ‘A’ from Standard & Poors. The obligations of the Authority as guarantor are limited to available moneys in the ADFA Guaranty Reserve Account created and being maintained pursuant to the authority conferred in the ADFA Guaranty Act.

In March 2003, Moody’s Investor Service downgraded its rating on outstanding tobacco settlement-related securitizations following the downgrade of the parent company of one of the larger tobacco companies. The tobacco bonds issued by ADFA in 2001 were downgraded from ‘Aa2’ to ‘A2’. The impact of the downgrade to the Authority has not been significant.

Independent Accountants' Report on Financial Statements and Supplementary Information

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

We have audited the accompanying statement of net assets of the Arkansas Development Finance Authority, a component unit of the State of Arkansas (the "Authority") as of June 30, 2003, and the related statements of revenues, expenses and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the Authority as of June 30, 2002, were audited by other accountants whose report dated October 9, 2002, expressed an unqualified opinion on those statements.

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

In our opinion, the 2003 financial statements referred to above present fairly, in all material respects, the financial position of the Authority as of June 30, 2003, and its changes in financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 18, 2003, on our consideration of the Authority's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The accompanying management's discussion and analysis as listed in the table of contents is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted primarily of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

The accompanying supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

/s/ **BKD, LLP**

Little Rock, Arkansas
September 18, 2003

**Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas**
Statements of Net Assets
June 30, 2003 and 2002

In thousands

	2003	2002
Current Assets		
Cash and cash equivalents	\$ 184,109	\$ 138,506
Accrued interest receivable		
Investments	4,472	5,525
Loans	2,169	2,823
Accounts receivable	1,046	1,196
Investments	194	100
Loans – current portion	797	8,557
Total current assets	192,787	156,707
Noncurrent Assets		
Deferred charges	8,061	9,211
Investments – unrestricted	68,944	29,064
Investments – restricted	991,350	1,062,304
Loans, net of allowance for loan losses of \$11,873 and \$12,932 at June 30, 2003 and 2002, respectively	336,321	351,430
Direct financing leases – restricted	84,591	82,093
Real estate owned	4,651	1,837
Capitalized assets, net	233	225
Total noncurrent assets	1,494,151	1,536,164
Total assets	1,686,938	1,692,871
Current Liabilities		
Accounts payable	3,276	4,880
Accrued interest payable	25,652	28,743
Bonds and notes payable – current portion	155,950	101,048
Total current liabilities	184,878	134,671
Noncurrent Liabilities		
Deferred fees	9,106	9,365
Bonds and notes payable, net of unamortized premiums and discounts	1,260,497	1,329,056
Deposits against financing arrangements	44,844	46,959
Total noncurrent liabilities	1,314,447	1,385,380
Total liabilities	1,499,325	1,520,051
Net Assets		
Restricted by bond resolution	126,245	122,801
Invested in capital assets	233	225
Unrestricted	61,135	49,794
Total net assets	\$ 187,613	\$ 172,820

**Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas**
Statements of Revenues, Expenses and Changes in Net Assets
Years Ended June 30, 2003 and 2002

In thousands

	2003	2002
Operating Revenues		
Investment income		
Interest and dividends	\$ 55,839	\$ 60,108
Loans and direct financing leases	22,544	24,726
Amortization of discounts on loans	5,673	6,974
Financing fees	3,539	2,926
Net increase in the fair value of investments	33,524	22,555
Total investment income	121,119	117,289
Other	183	40
Total operating revenues	121,302	117,329
Operating Expenses		
Interest on bonds and notes		
Current	78,632	84,514
Accreted	486	633
Total interest on bonds and notes	79,118	85,147
Amortization		
Amortization of discounts and premiums on bonds and notes	247	(16)
Amortization of bond and note issuance costs	1,858	1,474
Total amortization	2,105	1,458
Administrative expenses		
Provision for loan losses	520	2,767
Federal financial assistance programs	8,315	6,477
Salaries and benefits	3,711	3,285
Operations and maintenance	869	1,230
BMIR program participant expense	215	424
Other	2,074	3,352
Total administrative expenses	15,704	17,535
Total operating expenses	96,927	104,140
Operating Income	24,375	13,189
Nonoperating Revenue		
Federal grants	13,079	11,266
Income Before Transfers Out	37,454	24,455
Transfers Out	(22,661)	(2,876)
Change in Net Assets	14,793	21,579
Net Assets, Beginning of Year	172,820	151,241
Net Assets, End of Year	\$ 187,613	\$ 172,820

**Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas**
Statements of Cash Flows
Years Ended June 30, 2003 and 2002

In thousands

	2003	2002
Operating Activities		
Interest received on investments	\$ 56,892	\$ 60,759
Interest received on loans	23,198	25,216
Financing fee income received	3,798	2,876
Loan disbursements	(38,100)	(73,450)
Principal repayments on loans	62,701	105,874
Direct financing lease disbursements	(29,592)	(23,039)
Principal repayments on capital leases	27,094	10,967
Other cash received (paid)	(3,515)	348
Cash paid for interest	(81,723)	(84,637)
Cash paid for program administration	<u>(16,690)</u>	<u>(12,899)</u>
Net cash provided by operating activities	<u>4,063</u>	<u>12,015</u>
Noncapital Financing Activities		
Proceeds from issuance of bonds and notes payable	306,246	253,838
Repayments of bonds and notes payable	(320,636)	(334,568)
Nonoperating grants received	13,079	11,266
Transfers out	(22,661)	(2,876)
Payments of debt issuance costs	(867)	(903)
Collection of financing fees	<u>1,754</u>	<u>1,192</u>
Net cash used in noncapital financing activities	<u>(23,085)</u>	<u>(72,051)</u>
Investing Activities		
Purchase of investments	(1,005,541)	(1,271,606)
Maturities of investments	1,070,045	1,351,831
Proceeds from sale of real estate owned	227	—
Purchase of capitalized assets	<u>(106)</u>	<u>(102)</u>
Net cash provided by investing activities	<u>64,625</u>	<u>80,123</u>
Increase in Cash and Cash Equivalents	45,603	20,087
Cash and Cash Equivalents, Beginning of Year	<u>138,506</u>	<u>118,419</u>
Cash and Cash Equivalents, End of Year	<u>\$ 184,109</u>	<u>\$ 138,506</u>

**Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas**
Statements of Cash Flows (Continued)
Years Ended June 30, 2003 and 2002

	2003	2002
Reconciliation of Operating Income to Net Cash Provided By		
Operating Activities		
Operating income	\$ 24,375	\$ 13,189
Items not requiring (providing) operating activities cash flows		
Amortization of discounts on loans	(5,673)	(6,974)
Amortization of deferred financing fees	(1,768)	(1,734)
Accreted interest	486	633
Amortization of bond and note discounts	247	(16)
Amortization of bond and note issuance costs	1,858	1,474
Depreciation of capitalized assets	98	364
Provision for loan losses	520	2,767
Loss on sale of real estate owned	34	—
Provision for loss on real estate owned	346	—
Net appreciation of investments	(33,524)	(22,555)
Changes in		
Accounts receivable	150	309
Accrued interest receivable	1,707	1,141
Loans receivable	24,601	32,424
Direct financing leases	(2,498)	(12,072)
Other assets	159	886
Accounts payable	(1,604)	(1,422)
Accrued interest payable	(3,091)	(123)
Other liabilities	(2,360)	3,724
Net cash provided by operating activities	\$ 4,063	\$ 12,015
Supplemental Cash Flows Information		
Real estate acquired in settlement of loans	\$ 3,596	\$ 212
Sale and financing of real estate owned	\$ 175	\$ —

**Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas**
Notes to Financial Statements
June 30, 2003 and 2002

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations and Reporting Entity

The Arkansas Development Finance Authority, a Component Unit of the State of Arkansas (the "Authority") was created May 1, 1985, by Act 1062 of 1985 (Arkansas Development Finance Authority Act) as a successor to the former Arkansas Housing Development Agency (created in 1977) whereby all records, funds, property, obligations, debts, functions, powers and duties were transferred to the Authority. The Authority is a public body politic and corporate, with corporate succession, to be an independent instrumentality exercising essential public functions. Pursuant to Act 1062, the Authority is authorized and empowered to issue bonds and various other debt instruments for the purpose of financing qualified agricultural business enterprises, capital improvement facilities, educational facilities, health care facilities, housing developments and industrial enterprises.

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

Accounting Method

The Authority utilizes the proprietary fund method of accounting whereby operating revenues and expenses are distinguished from nonoperating items. 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. All revenues and expenses are recognized on the accrual basis. Pursuant to Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Authority has elected not to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB) issued after November 30, 1989, unless the GASB specifically adopts such FASB Statements or Interpretations. The Authority first applies restricted net assets when an expense or outlay is incurred for purposes for which both restricted and unrestricted net assets are available.

Fund Accounting

The Authority utilizes internal accounts, each of which includes accounts for the assets, liabilities, net assets, revenues and expenses of the Authority's programs and activities.

**Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas**
Notes to Financial Statements
June 30, 2003 and 2002

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

- (i) Single Family Housing Program
 - (a) *Single Family Mortgage Purchase Program* – Accounts for proceeds from single family mortgage revenue bonds, the debt service requirements of the bonds, and the related mortgage-backed securities or mortgage loans for single family owner-occupied housing in Arkansas.
 - (b) *Single Family Convertible Note Program* – A drawdown bond program utilized by ADFA to warehouse tax-exempt authority obtained through replacement refundings. The program utilizes privately placed, tax-exempt bonds, with the bond interest rate determined by collateral earnings.
- (ii) Federal Housing Programs
 - (a) *Section 8 Housing Assistance Payment Program* – Accounts for Section 8 housing assistance funds received in advance, housing assistance payment disbursements, and Authority fees and expenses related to the Section 8 Housing Assistance Payment Program.
 - (b) *HOME Partnership Program* – Accounts for federal financial assistance received from the Department of Housing and Urban Development for the purpose of developing and supporting affordable housing through tenant based rental assistance, rental rehabilitation, new construction, or assistance to homebuyers and homeowners.
- (iii) Multi-Family Programs
 - (a) *Multi-Family Mortgage Purchase Program* – Accounts for the proceeds of the multi-family mortgage revenue bonds, the debt service requirements of the bonds, and the related mortgage loans for multi-family housing in Arkansas, most of which are HUD approved and insured.
 - (b) *GNMA/BMIR Bond Program* – Accounts for proceeds from the sale of GNMA Guaranteed Bonds, debt service requirements on the bonds, related Below Market Interest Rate mortgages purchased with bond proceeds, disbursements to program participants of excess loan prepayments, and the Authority's fees and expenses in connection with the program.
 - (c) *FAF/New BMIR Loan Programs* – These programs were funded by distributions the Authority received from the GNMA/BMIR Bond Program as well as from Financing Adjustment Factor distributions from the federally funded Section 8 Housing Assistance Payment Program.

**Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas**
Notes to Financial Statements
June 30, 2003 and 2002

- (iv) Economic Development Bond Guaranty Program
 - (a) *Bond Guaranty Program* – Accounts for guaranty fees collected, interest earned on investments, and disbursements made in connection with bond guaranties provided by the Authority, as well as the proceeds from the sale of development revenue bonds issued by ADFA and guaranteed by the fund; the debt service requirements of the bonds and related loans and leases to private companies and one state commission. The fund was created by Act 505 of 1985 which authorized a grant of \$6 million from the State Treasurer (which was subsequently repaid by the Authority) for the purpose of enhancing and supporting the creditworthiness of bonds and other debt instruments guaranteed by the Authority. At June 30, 2003 and 2002, the fund has cash and cash equivalents and investments totaling \$21.9 million and \$23.9 million, respectively, in the reserve account to collateralize Authority-guaranteed bonds and future issues under the bond guaranty program.
- (v) Economic Development State and Health Facilities Programs
 - (a) *State and Health Facilities Programs* – Accounts for the proceeds from the sale of development revenue bonds; the debt service requirements of the bonds and related loans and leases to public and private institutions and government bodies within the State of Arkansas; and includes certain assets not owned and related obligations not owed by the Authority.
- (vi) Other Economic Development Programs
 - (a) *Other Economic Development Programs* – Accounts for the proceeds from the sale of the Higher Education Capital Asset Program bonds and a note payable for the Intermediary Relending Program; the related debt service requirements of the bonds and note and related loans to private businesses and public higher education institutions. Also, accounts for loan reserve programs, such as Capital Access, Business Life and Disadvantaged Business Enterprise.
- (vii) Tobacco Bond Program
 - (a) *Tobacco Settlement Revenue Bonds, Series 2001* – Accounts for the proceeds from the sale of tobacco settlement revenue bonds; the debt service requirements of the bonds and related disbursements of bond proceeds to participating colleges to be used to fund the construction and equipping of three projects outlined by the Arkansas Tobacco Settlement Funds Act of 2000.
- (viii) Other Programs and General Fund
 - (a) *ADFA General Fund* – Accounts for revenue charged by the Authority for issuing and administering various programs; operating expenses of the Authority; special initiatives of the Authority, such as direct loan programs; and money or residual assets, such as mortgages, transferred from other funds to the extent such transfers are permitted by the resolutions.

**Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas**
Notes to Financial Statements
June 30, 2003 and 2002

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.

Cash and Cash Equivalents

The Authority considers all liquid investments with original maturities of three months or less to be cash equivalents. At June 30, 2003 and 2002, cash equivalents of \$183.2 million and \$137.7 million, respectively, consisted primarily of money market mutual funds with variable interest rates.

Investments and Investment Income

Investments are carried at fair value. Fair value is determined using quoted market prices, if available.

Investment income includes dividend and interest income, realized gains and losses on investments carried at other than fair value and the net change for the year in the fair value of investments carried at fair value.

The fair value of the investments at June 30, 2003 and 2002, was in excess of the cost basis by \$54.5 million and \$22.1 million, respectively.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoffs are reported at their outstanding principal balances adjusted for any charge-offs, the allowance for loan losses and any deferred fees or costs on origination. Interest income is reported using the interest method and includes amortization of net deferred loan fees and costs over the loan term. Generally, loans are placed on non-accrual status at 180 days past due and interest is considered a loss, unless the loan is well-secured and in the process of collection.

Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to income. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

**Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas**
Notes to Financial Statements
June 30, 2003 and 2002

A loan is considered impaired when, based on current information and events, it is probable that the Authority will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price or the fair value of the collateral if the loan is collateral dependent.

Income Taxes

As an essential government function of the State of Arkansas, the Authority is exempt from income taxes under Section 115 of the Internal Revenue Code and a similar provision of state law.

Direct Financing Leases

The Authority issues revenue bonds to provide financing of correction facilities, office space for the State of Arkansas and certain transactions for private companies. In all cases, the Authority does not maintain or operate the facilities. Arrangements of this type are accounted for in the various funds as financing arrangements in accordance with the provisions of Financial Accounting Standards Board Statement No. 13, *Accounting for Leases*.

Deferred Charges

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

Capitalized Assets

Furniture, fixtures and equipment are carried at cost, less accumulated depreciation. Depreciation for financial statement purposes is computed using the straight-line method over the estimated useful lives of the assets ranging from 3 to 10 years.

**Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas**
Notes to Financial Statements
June 30, 2003 and 2002

Deposits Against Financing Arrangements

Deposits against financing arrangements represent debt service funds and interest earned on funds created by trust indentures associated with bond issuances that are held by the Authority to be used by the borrower to pay debt service to the Authority. If not used to pay debt service, these funds are returned to the borrower at the end of the financing arrangement.

Deferred Fees

The Authority receives commitment fees for earmarking funds and financing fees from borrowers. Deferred commitment fees which are nonrefundable are amortized into income ratably over the term of the respective programs based on the balance of bonds outstanding, which approximates the mortgage loans outstanding.

Conduit Debt Obligations

Conduit debt issued by the Authority is recorded on the Authority's balance sheet if either (a) the Authority has a vested interest in the residual value of the bond issue after its retirement or (b) the Authority guarantees the debt through the Bond Guaranty fund. Additionally, the Authority reports conduit debt obligations of entities that are included in the State of Arkansas reporting entity on its statement of net assets.

Net Assets

Restricted by Bond Resolution – Represents those funds restricted within the respective bond resolution.

Invested in Capital Assets – Represents the balance of capital assets, net of depreciation. No related debt exists.

Unrestricted Net Assets – Represents those funds used at the discretion of ADFA's Board of Directors to compliment bond and loan programs and to provide for the Authority's operations.

Reclassifications

Certain reclassifications have been made to the 2002 financial statements to conform to the 2003 financial statement presentation. These reclassifications had no effect on net assets.

**Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas**
Notes to Financial Statements
June 30, 2003 and 2002

Note 2: Deposits and Investments

Deposits

At June 30, 2003 and 2002, the carrying value and the bank balance of the Authority's deposits were as follows:

<i>In thousands</i>	2003	2002
Insured (FDIC) or collateralized with securities held by the Authority or the Authority's agent in the Authority's name	\$ <u>2,061</u>	\$ <u>3,000</u>
Carrying value	\$ <u>1,235</u>	\$ <u>2,744</u>

State law requires collateralization of all deposits with federal depository insurance and other acceptable collateral in specific amounts. No legal opinion has been obtained regarding the enforceability of any of the collateral arrangements.

Investments

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

**Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas**
Notes to Financial Statements
June 30, 2003 and 2002

Investments at June 30, 2003, by security type and level of credit risk:

<i>In thousands</i>	Category			Fair Value
Security Type	1	2	3	Value
Categorized				
U.S. Government and agency securities	\$ 819,555	\$ —	\$ —	\$ 819,555
Commercial paper	253	—	—	253
Repurchase agreements	<u>1,131</u>	<u>—</u>	<u>—</u>	<u>1,131</u>
Total investments categorized by investment type	<u>\$ 820,939</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>820,939</u>
Uncategorized				
Investment agreements				239,254
Money market mutual funds				<u>183,169</u>
Total uncategorized				<u>422,423</u>
Total investments				<u>\$ 1,243,362</u>

Investments at June 30, 2002, by security type and level of credit risk:

<i>In thousands</i>	Category			Fair Value
Security Type	1	2	3	Value
Categorized				
U.S. Government and agency securities	\$ 915,980	\$ —	\$ —	\$ 915,980
Commercial paper	253	—	—	253
Repurchase agreements	<u>2,348</u>	<u>—</u>	<u>—</u>	<u>2,348</u>
Total investments categorized by investment type	<u>\$ 918,581</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>918,581</u>
Uncategorized				
Investment agreements				170,978
Money market mutual funds				<u>137,671</u>
Total uncategorized				<u>308,649</u>
Total investments				<u>\$ 1,227,230</u>

**Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas**
Notes to Financial Statements
June 30, 2003 and 2002

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

The following schedule reconciles the carrying amount of investments as disclosed above to the statement of net assets:

<i>In thousands</i>	2003	2002
Reported amount of investments	\$ 1,243,362	\$ 1,227,230
Cash equivalents disclosed as investments for GASB 3	295	942
Investments disclosed as cash equivalents for GASB 3	(183,169)	(136,704)
Investments as reported on the statement of net assets	\$ 1,060,488	\$ 1,091,468

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

**Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas**
Notes to Financial Statements
June 30, 2003 and 2002

Summary of Carrying Values

The carrying values of deposits and investments shown above are included in the balance sheets as follows:

	2003	2002
Carrying value		
Deposits	\$ 1,235	\$ 2,744
Investments	<u>1,243,362</u>	<u>1,227,230</u>
	<u>\$ 1,244,597</u>	<u>\$ 1,229,974</u>
Included in the following balance sheet captions		
Cash and cash equivalents	\$ 184,109	\$ 138,506
Investments – current portion	194	100
Investments – unrestricted	68,944	29,064
Investments – restricted	<u>991,350</u>	<u>1,062,304</u>
	<u>\$ 1,244,597</u>	<u>\$ 1,229,974</u>

Note 3: Loans

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

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

**Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas**
Notes to Financial Statements
June 30, 2003 and 2002

Bond Guaranty Programs – Loans and leases to private companies for financing the acquisition or expansion of facilities are collateralized by liens on and security interests in collateral granted by the companies and by guaranty agreements between the Authority and one or more guarantors. To a limited extent and only when specified by a specific trust indenture, the payment of principal and interest on the bonds is guaranteed by the Authority under the ADFB Bond Guaranty Act (Act 505 of 1985). At June 30, 2003 and 2002, respectively, the Authority reported in its statement of net assets \$62.0 million and \$52.9 million in loans and leases to private companies and with an agency of the State of Arkansas as well as \$75.6 million and \$70.4 million in related bond issues which are guaranteed by the Bond Guaranty Fund. Differences between the loan balance and the related bond balance are attributed primarily to the allowance for loan loss of \$7.5 million and \$8.8 million, construction draw payable accounts of \$2.6 million and \$5.3 million, and timing differences between loan collection and bond payment of \$4.1 million and \$6.3 million offset by loans with no associated bonds of \$0.7 million and \$3.1 million at June 30, 2003 and 2002, respectively. Additionally, the Bond Guaranty Fund guarantees principal and interest on revenue bonds issued by municipalities within the State of Arkansas for economic development purposes. At June 30, 2003 and 2002, bonds outstanding of \$10.7 million and \$8.7 million, respectively, were guaranteed by the Bond Guaranty Fund. Furthermore, the Bond Guaranty Fund guarantees principal and interest on bond anticipation notes. At June 30, 2002, principal guaranteed on these notes totaled \$4.9 million.

State and Health Facilities Programs – Includes financing activities with various state agencies and health facilities. At June 30, 2003 and 2002, respectively, the Authority reported loans of \$87.6 million and \$88.2 million, direct financing leases of \$77.3 million and \$78.6 million, and bonds outstanding of \$169.0 million and \$185.1 million related to the financing arrangements with these institutions and agencies. Differences between the loan and lease balances and the related bond balance are attributed primarily to construction draw payable accounts of \$5.5 million and \$16.9 million.

Other Economic Development Programs – Includes financing activities with educational institutions and financing activities to private companies through various means. At June 30, 2003 and 2002, respectively, the Authority reported loans of \$12.0 million and \$11.8 million, and bonds and note payable of \$18.2 million and \$18.4 million. Differences between the loan balances and the related bonds and notes payable balances are attributed primarily to an investment account balance of \$6.5 million for June 30, 2003 and 2002.

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

Construction draw payables will be advanced to a customer as long as there is no violation of any condition established in the contract. Construction draw payables generally have fixed expiration dates or other termination clauses. Since a portion of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Each customer's creditworthiness is evaluated on a case-by-case basis. The amount of collateral obtained is based on management's credit evaluation of the counterparty. Collateral held varies, but may include accounts receivable, inventory, property, plant and equipment and commercial real estate.

**Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas**
Notes to Financial Statements
June 30, 2003 and 2002

The stated interest rates on the loans are as follows:

	Stated Interest Rate
Single Family Housing Program Fund	5.95 to 10.78%
Multi-Family Housing Program Fund	0.00 to 8.79%
Bond Guaranty Programs	Rate on bonds
State and Health Facilities Programs	Rate on bonds
Other Economic Development Programs	
U.S. Department of Agriculture/Farmers Home Administration	3%
Higher Education Capital Access Program	Rate on bonds
General Fund Programs	0.00 to 8.50%

Impaired loans totaled \$29.5 million at June 30, 2003. An allowance for loan losses of \$4.9 million relates to impaired loans of \$17.9 million, at June 30, 2003. At June 30, 2003, impaired loans of \$11.6 million, had no related allowance for loan losses.

At June 30, 2003, accruing loans delinquent 90 days or more totaled \$2.1 million. Non-accruing loans at June 30, 2003 were \$26.0 million.

Note 4: Net Investment in Direct Financing Leases

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

**Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas**
Notes to Financial Statements
June 30, 2003 and 2002

<i>In thousands</i>	<u>Lease Payments</u>
Year ending June 30	
2004	\$ 10,432
2005	11,118
2006	11,102
2007	10,817
2008	10,777
2009 – 2013	36,458
2014 – 2018	13,955
2019 – 2023	<u>4,627</u>
Total minimum lease payments receivable	109,286
Less amount representing interest	<u>(24,695)</u>
Present value of minimum lease payments receivable	<u>\$ 84,591</u>

Note 5: Capitalized Assets

Premises and equipment at June 30 are summarized as follows:

<i>In thousands</i>	<u>2003</u>	<u>2002</u>
Cost		
Furniture, fixtures and equipment	\$ 595	\$ 752
Less accumulated depreciation	<u>(362)</u>	<u>(527)</u>
Net	<u>\$ 233</u>	<u>\$ 225</u>

Depreciation expense for the years ending June 30, 2003 and 2002, respectively, was approximately \$98,000 and \$364,000.

**Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas**
Notes to Financial Statements
June 30, 2003 and 2002

Note 6: Bonds and Notes Payable

Bonds and notes payable at June 30 were as follows:

<i>In thousands</i>	2003	2002
Total Single Family Bonds and Note Payable, with interest rates ranging from 1.15 – 10.00% and final maturity at varying dates through 2034	\$ 911,302	\$ 921,540
Less unamortized discount/plus unamortized premium	<u>(223)</u>	<u>(217)</u>
Total Single Family Bonds Payable, net	<u>911,079</u>	<u>921,323</u>
Total Multi-Family Bonds Payable, with interest rates ranging from 2.40 – 9.75% and final maturity at varying dates through 2035	157,050	170,187
Less unamortized discount/plus unamortized premium	<u>(1,107)</u>	<u>(1,240)</u>
Total Multi-Family Bonds, net	<u>155,943</u>	<u>168,947</u>
Total Economic Development Bonds Payable, Guaranteed by the Bond Guaranty Fund, with interest rates ranging from 1.58 – 8.48% and final maturity at varying dates through 2021	<u>75,615</u>	<u>70,351</u>
Total State and Health Facilities Bonds Payable, with interest rates ranging from 1.60 – 7.00% and final maturity at varying dates through 2029	169,220	185,454
Less unamortized discount/plus unamortized premium	<u>(246)</u>	<u>(343)</u>
Total State and Health Facilities Bonds Payable, net	<u>168,974</u>	<u>185,111</u>
Total Other Economic Development Bonds and Note Payable, with interest rates ranging from 1.00 – 5.70% and final maturity at varying rates through 2023	18,315	18,534
Less unamortized discount/plus unamortized premium	<u>(139)</u>	<u>(162)</u>
Total Other Economic Development Bonds Payable, net	<u>18,176</u>	<u>18,372</u>
Tobacco Bond Payable, with interest rates ranging from 2.80 – 5.50% and final maturity at varying dates through 2041	<u>60,000</u>	<u>60,000</u>
Total General Fund Note Payable, with interest rates ranging from 1.02 – 1.69% and final maturity at varying dates through 2003	<u>26,660</u>	<u>6,000</u>
Total all programs bonds and notes payable, net	<u>\$ 1,416,447</u>	<u>\$ 1,430,104</u>

**Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas**
Notes to Financial Statements
June 30, 2003 and 2002

Activity in bonds and notes payable for 2003 was as follows:

<i>In thousands</i>	Beginning Balance	Additions Including Accretion	Reductions	Ending Balance	Amount Due within One Year
Bonds payable	\$ 1,364,768	\$ 101,944	\$ (197,599)	\$ 1,269,113	\$ 43,929
Notes payable	<u>67,298</u>	<u>204,788</u>	<u>(123,037)</u>	<u>149,049</u>	<u>112,021</u>
	1,432,066	306,732	(320,636)	1,418,162	155,950
Unamortized premiums (discounts)	<u>(1,962)</u>	<u>—</u>	<u>247</u>	<u>(1,715)</u>	<u>—</u>
Total long - term debt	<u>\$ 1,430,104</u>	<u>\$ 306,732</u>	<u>\$ (320,389)</u>	<u>\$ 1,416,447</u>	<u>\$ 155,950</u>

Activity in bonds and notes payable for 2002 was as follows:

<i>In thousands</i>	Beginning Balance	Additions Including Accretion	Reductions	Ending Balance
Bonds payable	\$ 1,429,365	\$ 188,521	\$ (253,118)	\$ 1,364,768
Notes payable	<u>81,246</u>	<u>67,502</u>	<u>(81,450)</u>	<u>67,298</u>
	1,510,611	256,023	(334,568)	1,432,066
Unamortized premiums (discounts)	<u>(394)</u>	<u>(1,550)</u>	<u>(18)</u>	<u>(1,962)</u>
Total long - term debt	<u>\$ 1,510,217</u>	<u>\$ 254,473</u>	<u>\$ (334,586)</u>	<u>\$ 1,430,104</u>

Future amounts required to pay principal and interest on all bonds and notes payable at June 30, 2003, were as follows:

<i>In thousands</i>	Principal	Interest
Year Ending June 30		
2004	\$ 155,950	\$ 74,550
2005	80,686	71,001
2006	50,327	67,756
2007	50,525	64,546
2008	50,143	61,331
2009 – 2013	240,100	265,507
2014 – 2018	242,032	196,746
2019 – 2023	186,063	132,488
2024 – 2028	210,925	76,645
2029 – 2033	130,850	21,745
2034 – 2038	17,375	2,083
2039 – 2043	<u>3,186</u>	<u>345</u>
	1,418,162	1,034,743
Unamortized premiums and discounts	<u>(1,715)</u>	<u>—</u>
Total	<u>\$ 1,416,447</u>	<u>\$ 1,034,743</u>

**Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas**
Notes to Financial Statements
June 30, 2003 and 2002

The Authority has entered into an interest rate swap agreement to effectively convert \$10 million of variable rate debt based on the 3-month LIBOR to fixed rate debt with an effective rate of 7.698%. The Authority is exposed to interest rate risk under the swap agreement if the 3-month LIBOR rate is less than 7.418%. The interest rate swap agreement is set to expire January 2, 2014.

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

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

As of June 30, 2003, the remaining principal amounts outstanding on issues defeased in previous years are as follows:

<i>In thousands</i>	Issue	Date of Defeasance	Principal Outstanding
	1979 Series A Single Family Conventional Bonds	September 1988	\$ 46,255
	1993 Series C State Agencies Facilities Revenue Bonds	October 2001	<u>2,170</u>
			<u>\$ 48,425</u>

During the normal course of business, the Authority issues economic development revenue bonds and multi-family housing revenue bonds on behalf of private companies within the State of Arkansas. The bonds are payable solely from and secured by a pledge of revenues from the private companies to which the bond proceeds were remitted and accordingly, have been excluded from the Authority's financial statements. At June 30, 2003 and 2002, respectively, the bonds outstanding issued under these programs aggregated \$426.7 million and \$373.6 million.

The Authority pledged \$26.7 million of securities as collateral for advances to the Federal Home Loan Bank in the amount of \$26.7 million.

Note 7: Concentrations of Risk in Lending and Loan Receivable Insurance

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

**Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas**
Notes to Financial Statements
June 30, 2003 and 2002

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

Note 8: Retirement Plan

The officials and employees of the Authority participate in a state-wide, multiple-employer public employee retirement system administered by the Arkansas Public Employees Retirement System (the "System"). There is no legal obligation imposed upon the member agencies relative to the operation of the System other than the payment of a percent of the gross salaries of eligible employees participating in the System as an employer contribution. State law provides that Authority contributions for all covered state employees are to be based on 10% of gross payroll. All contributions required of the Authority were made for the years ended June 30, 2003 and 2002. For the years ended June 30, 2003 and 2002, the Authority's covered payroll and total payroll for all employees amounted to \$3.7 million and \$3.3 million, respectively.

The contributory plan has been in effect since the beginning of the System, and is available to all persons who became members before January 1, 1978. The noncontributory plan was effective January 1, 1978, and applies automatically to all persons hired January 1, 1978, or later in System covered employment. Employees joining the System prior to July 1, 1997, are vested after ten years of employment. Beginning July 1, 1997, the vesting period for new members was reduced to five years. A member covered by the contributory plan can elect to be covered by the noncontributory plan, and the change will be effective January 1, 1978, regardless of when the election was made. The System is audited separately, and included therein is financial data and trend information which gives an indication of the extent to which the system is accumulating sufficient assets to pay benefits when due.

Note 9: Contingencies

The Authority participates in numerous state and federal grant programs, which are governed by various rules and regulations of the grantor agencies. Costs charged to the respective grant programs are subject to audit and adjustment by the grantor agencies; therefore, to the extent that the Authority has not complied with the rules and regulations governing the grants, refunds of any money received may be required, and the collectibility of any related receivable at June 30, 2003 and 2002, may be impaired. In the opinion of the Authority, there are no significant contingent liabilities relating to compliance with the rules and regulations governing the respective grants; therefore, no provision has been recorded in the accompanying financial statements for such contingencies.

**Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas**
Notes to Financial Statements
June 30, 2003 and 2002

The Authority currently participates in an arrangement whereby a liability may be created through prepayments of debt associated with a loan portfolio recorded in the Multi-Family Housing Programs Fund. A portion of the prepayments of loan principal in this portfolio are reinvested in investments to cover future debt service payments associated with this portfolio. Any excess amount is then disbursed to various housing agencies in other states based on a participation agreement.

The Authority has \$14.0 million and \$30.0 million of amounts recorded as cash and investments in the statement of net assets that will be disbursed to borrowers under loan and lease agreements closed prior to June 30, 2003 and 2002, respectively.

The Authority is a defendant in a number of legal actions. While the final outcome of many of these legal actions cannot be determined at this time, management is of the opinion that the ultimate liability, if any, for these legal actions will not have a material effect on the Authority's financial position.

The Internal Revenue Code of 1986 establishes rules and regulations for arbitrage rebates. The Authority has made provisions for revenues above the rebate limit which must be remitted to the Federal Government.

The Authority offers continuous lending in its HomeToOwn Single Family Program, which offers thirty-year mortgage loans to first time homebuyers, subject to income and purchase price limitations. The Authority allows lenders to reserve funds at a specific interest rate via the Internet. The interest rate is determined by the Authority and can change at any time, based on program volume, conventional mortgage rates, and other factors. At the time of the reservation, the Authority may or may not have corresponding long-term bonds to fund the loans. This exposes the Authority to interest rate risk. At June 30, 2003, the Authority had accepted loan reservations of \$42.1 million, for which there were no corresponding long-term bonds.

The Internal Revenue Service limits the amount of interest rate spread that an issuer can earn on tax-exempt single family mortgage revenue bonds. In some of its previous bond issues, the Authority earned in excess of the allowed amount. In order to maintain compliance with the IRS, the excess is directed to bond issues earning less than the allowed amount. At June 30, 2003, the present value of excess subsidy was approximately \$12.0 million. In the event the cost of long-term bonds exceeds the reserved loan rates, the Authority would utilize this subsidy to limit losses.

The Venture Capital Investment Act of 2001 authorizes the Authority to assist in increasing the availability of equity and near-equity capital for emerging, expanding, relocating and restructuring enterprises in the state through the creation of an institutional partnership fund. The Authority is authorized to provide its guaranty to certain obligations utilizing the Bond Guaranty fund, up to \$10.0 million. After the guaranty funds are exhausted, the State of Arkansas will issue tax credits. For fiscal year ending June 30, 2003, there had been no investments made by the fund.

Supplementary Information

**Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas**
Combining Statement of Net Assets
June 30, 2003

<i>In thousands</i>	Single Family Housing Programs	Federal Housing Programs	Multi-Family Programs	Economic Development Bond Guaranty Program
Current Assets				
Cash and cash equivalents	\$ 117,343	\$ 179	\$ 8,075	\$ 7,792
Accrued interest receivable	3,938	30	385	442
Accounts receivable	1,918	56	31	2
Investments	—	—	—	—
Loans – current portion	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Total current assets	<u>123,199</u>	<u>265</u>	<u>8,491</u>	<u>8,236</u>
Noncurrent Assets				
Deferred charges	7,243	—	817	1
Investments – unrestricted	—	—	—	—
Investments – restricted	857,075	—	72,376	24,080
Loans receivable, net	36,842	27,211	105,113	54,745
Direct financing leases – restricted	—	—	—	7,305
Real estate owned	—	161	205	4,252
Capitalized assets, net	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Total noncurrent assets	<u>901,160</u>	<u>27,372</u>	<u>178,511</u>	<u>90,383</u>
Total assets	<u>1,024,359</u>	<u>27,637</u>	<u>187,002</u>	<u>98,619</u>
Current Liabilities				
Accounts payable	2,870	283	3,718	43
Accrued interest payable	21,218	—	1,797	835
Bonds and notes payable – current portion	<u>98,091</u>	<u>—</u>	<u>14,122</u>	<u>5,922</u>
Total current liabilities	<u>122,179</u>	<u>283</u>	<u>19,637</u>	<u>6,800</u>
Noncurrent Liabilities				
Deferred fees	6,385	—	437	2,262
Bonds and notes payable, net of unamortized discounts and premiums	812,988	—	141,821	69,693
Deposits against financing arrangements	<u>—</u>	<u>—</u>	<u>123</u>	<u>2,233</u>
Total noncurrent liabilities	<u>819,373</u>	<u>0</u>	<u>142,381</u>	<u>74,188</u>
Total liabilities	<u>941,552</u>	<u>283</u>	<u>162,018</u>	<u>80,988</u>
Net Assets				
Restricted by bond resolution	82,807	27,354	24,984	17,631
Invested in capital assets	—	—	—	—
Unrestricted	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Total net assets	<u>\$ 82,807</u>	<u>\$ 27,354</u>	<u>\$ 24,984</u>	<u>\$ 17,631</u>

State and Health Facilities Programs	Other Economic Development Programs	Tobacco Bond Program	General Fund Programs	Eliminations	Total
\$ 41,451	\$ 4,075	\$ 3,175	\$ 2,019	\$ —	\$ 184,109
1,347	32	23	444	—	6,641
—	38	—	3,056	(4,055)	1,046
—	—	—	194	—	194
—	—	—	797	—	797
<u>42,798</u>	<u>4,145</u>	<u>3,198</u>	<u>6,510</u>	<u>(4,055)</u>	<u>192,787</u>
—	—	—	—	—	8,061
—	—	—	68,944	—	68,944
4,377	6,450	26,992	—	—	991,350
87,639	12,033	—	12,738	—	336,321
77,286	—	—	—	—	84,591
—	—	—	33	—	4,651
—	—	—	233	—	233
<u>169,302</u>	<u>18,483</u>	<u>26,992</u>	<u>81,948</u>	<u>0</u>	<u>1,494,151</u>
<u>212,100</u>	<u>22,628</u>	<u>30,190</u>	<u>88,458</u>	<u>(4,055)</u>	<u>1,686,938</u>
19	—	—	398	(4,055)	3,276
1,490	36	246	30	—	25,652
<u>9,830</u>	<u>225</u>	<u>1,100</u>	<u>26,660</u>	<u>—</u>	<u>155,950</u>
<u>11,339</u>	<u>261</u>	<u>1,346</u>	<u>27,088</u>	<u>(4,055)</u>	<u>184,878</u>
22	—	—	—	—	9,106
159,144	17,951	58,900	—	—	1,260,497
<u>41,350</u>	<u>380</u>	<u>756</u>	<u>2</u>	<u>—</u>	<u>44,844</u>
<u>200,516</u>	<u>18,331</u>	<u>59,656</u>	<u>2</u>	<u>0</u>	<u>1,314,447</u>
<u>211,855</u>	<u>18,592</u>	<u>61,002</u>	<u>27,090</u>	<u>(4,055)</u>	<u>1,499,325</u>
245	4,036	(30,812)	—	—	126,245
—	—	—	233	—	233
—	—	—	61,135	—	61,135
<u>\$ 245</u>	<u>\$ 4,036</u>	<u>\$ (30,812)</u>	<u>\$ 61,368</u>	<u>\$ 0</u>	<u>\$ 187,613</u>

**Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas**
Combining Statement of Revenues, Expenses and Changes in Net Assets
Year Ended June 30, 2003

<i>In thousands</i>	Single Family Housing Programs	Federal Housing Programs	Multi-Family Programs	Economic Development Bond Guaranty Program
Operating Revenues				
Investment income				
Interest and dividends	\$ 49,665	\$ 1	\$ 1,985	\$ 1,269
Loans and direct financing leases	3,471	115	5,193	3,658
Amortization of discounts on loans	—	—	5,673	—
Financing fees	1,253	14	105	559
Net increase in the fair value of investments	<u>26,114</u>	<u>—</u>	<u>4,430</u>	<u>1,076</u>
Total investment income	80,503	130	17,386	6,562
Other	<u>—</u>	<u>—</u>	<u>181</u>	<u>—</u>
Total operating revenues	<u>\$ 80,503</u>	<u>\$ 130</u>	<u>\$ 17,567</u>	<u>\$ 6,562</u>

State and Health Facilities Programs	Other Economic Development Programs	Tobacco Bond Program	General Fund Programs	Eliminations	Total
\$ 9	\$ 219	\$ —	\$ 2,691	\$ —	\$ 55,839
8,966	230	—	911	—	22,544
—	—	—	—	—	5,673
—	78	—	3,425	(1,895)	3,539
<u>159</u>	<u>—</u>	<u>—</u>	<u>1,745</u>	<u>—</u>	<u>33,524</u>
9,134	527	0	8,772	(1,895)	121,119
<u>—</u>	<u>—</u>	<u>—</u>	<u>2</u>	<u>—</u>	<u>183</u>
<u>\$ 9,134</u>	<u>\$ 527</u>	<u>\$ 0</u>	<u>\$ 8,774</u>	<u>\$ (1,895)</u>	<u>\$ 121,302</u>

Arkansas Development Finance Authority,
A Component Unit of the State of Arkansas
Combining Statement of Revenues, Expenses and Changes in Net Assets
(Continued)
Year Ended June 30, 2003

	Single Family Housing Programs	Federal Housing Programs	Multi-Family Programs	Economic Development Bond Guaranty Program
Operating Expenses				
Interest on bonds and notes				
Current	\$ 48,209	\$ —	\$ 13,956	\$ 3,973
Accreted	<u>486</u>	<u>—</u>	<u>—</u>	<u>—</u>
Total interest on bonds and notes	<u>48,695</u>	<u>0</u>	<u>13,956</u>	<u>3,973</u>
Amortization				
Amortization of discounts and premiums on bonds and notes	(6)	—	133	—
Amortization of bond and note issuance costs	<u>1,661</u>	<u>—</u>	<u>197</u>	<u>—</u>
Total amortization	<u>1,655</u>	<u>0</u>	<u>330</u>	<u>0</u>
Administrative expenses				
Provision for loan losses	—	600	(246)	4
Federal financial assistance programs	—	8,837	—	—
Salaries and benefits	—	—	—	—
Operations and maintenance	—	—	—	—
BMIR program participant expense	—	—	215	—
Other	<u>1,721</u>	<u>362</u>	<u>365</u>	<u>(109)</u>
Total administrative expenses	<u>1,721</u>	<u>9,799</u>	<u>334</u>	<u>(105)</u>
Total operating expenses	<u>52,071</u>	<u>9,799</u>	<u>14,620</u>	<u>3,868</u>
Operating Income (Loss)	28,432	(9,669)	2,947	2,694
Nonoperating Revenue				
Federal grants	<u>—</u>	<u>12,522</u>	<u>463</u>	<u>—</u>
Income (Loss) Before Transfers In (Out)	28,432	2,853	3,410	2,694
Transfers In (Out)	<u>(2,523)</u>	<u>(176)</u>	<u>(5,512)</u>	<u>17</u>
Change in Net Assets	25,909	2,677	(2,102)	2,711
Net Assets, Beginning of Year	<u>56,898</u>	<u>24,677</u>	<u>27,086</u>	<u>14,920</u>
Net Assets, End of Year	<u>\$ 82,807</u>	<u>\$ 27,354</u>	<u>\$ 24,984</u>	<u>\$ 17,631</u>

State and Health Facilities Programs	Other Economic Development Programs	Tobacco Bond Program	General Fund Programs	Eliminations	Total
\$ 8,976	\$ 275	\$ 2,945	\$ 298	\$ —	\$ 78,632
<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>486</u>
<u>8,976</u>	<u>275</u>	<u>2,945</u>	<u>298</u>	<u>0</u>	<u>79,118</u>
97	23	—	—	—	247
<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>1,858</u>
<u>97</u>	<u>23</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>2,105</u>
—	5	—	157	—	520
—	—	—	—	(522)	8,315
—	—	—	3,711	—	3,711
—	—	—	869	—	869
—	—	—	—	—	215
<u>2</u>	<u>345</u>	<u>—</u>	<u>761</u>	<u>(1,373)</u>	<u>2,074</u>
<u>2</u>	<u>350</u>	<u>0</u>	<u>5,498</u>	<u>(1,895)</u>	<u>15,704</u>
<u>9,075</u>	<u>648</u>	<u>2,945</u>	<u>5,796</u>	<u>(1,895)</u>	<u>96,927</u>
59	(121)	(2,945)	2,978	0	24,375
<u>—</u>	<u>—</u>	<u>—</u>	<u>94</u>	<u>—</u>	<u>13,079</u>
59	(121)	(2,945)	3,072	0	37,454
<u>—</u>	<u>(11)</u>	<u>(22,733)</u>	<u>8,277</u>	<u>—</u>	<u>(22,661)</u>
59	(132)	(25,678)	11,349	0	14,793
<u>186</u>	<u>4,168</u>	<u>(5,134)</u>	<u>50,019</u>	<u>—</u>	<u>172,820</u>
<u>\$ 245</u>	<u>\$ 4,036</u>	<u>\$ (30,812)</u>	<u>\$ 61,368</u>	<u>\$ 0</u>	<u>\$ 187,613</u>