

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

Auditor's Report and Financial Statements

June 30, 2014 and 2013



State of Arkansas Safe Drinking Water Revolving Loan Fund Program

June 30, 2014 and 2013

Contents

Independent Auditor's Report	1
Management's Discussion and Analysis	4
Financial Statements	
Statements of Net Position	9
Statements of Revenues, Expenses and Changes in Net Position	10
Statements of Cash Flows	11
Notes to Financial Statements	12
Supplementary Information	
Combining Statement of Net Position	21
Combining Statement of Revenues, Expenses and Changes in Net Position	22
Combining Statement of Cash Flows	23

Independent Auditor's Report

The Commissioners of the Arkansas Natural
Resources Commission (ANRC)

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

We have audited the accompanying basic financial statements of the State of Arkansas Safe Drinking Water Revolving Loan Fund Program (the Program), which are comprised of statements of net position as of June 30, 2014 and 2013, and the related statements of revenues, expenses and changes in net position and statements of cash flows for the years ended June 30, 2014 and 2013, and the related notes to the basic financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

The Commissioners of the Arkansas Natural
Resources Commission (ANRC)

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

Page 2

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Program as of June 30, 2014 and 2013, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

As discussed in *Note 6* to the financial statements, in 2014 the Program adopted new accounting guidance, Governmental Accounting Standards Board Statement No. 65, *Items Previously Reported as Assets and Liabilities*, by restating the 2013 financial statements. Our opinion is not modified with respect to this matter.

As discussed in *Note 1*, the financial statements of the Program are intended to present the financial position, and the changes in financial position and cash flows, where applicable, of only that portion of the business-type activities of the State of Arkansas (the State) that is attributable to the transactions of the Program. They do not purport to, and do not, present fairly the financial position of the State as of June 30, 2014 and 2013, and the changes in its financial position and its cash flows, where applicable, for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

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

The Commissioners of the Arkansas Natural
Resources Commission (ANRC)

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

Page 3

Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the basic financial statements as a whole. The supplementary information listed in the table of contents, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audits of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated October 31, 2014, on our consideration of the Program's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Program's internal control over financial reporting and compliance.

BKD, LLP

Little Rock, Arkansas
October 31, 2014

**State of Arkansas Safe Drinking Water
Revolving Loan Fund Program
Management's Discussion and Analysis
June 30, 2014 and 2013**

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

Discussion of Financial Statements

The June 30, 2014, basic financial statements include three required statements: the statement of net position; the statement of revenues, expenses and changes in net position; and the statement of cash flows. Comparative totals as of and for the years ended June 30, 2013 and 2012, 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. The Program adopted a new accounting principle that resulted in a restatement of net position. These changes are reflected as a restatement to beginning net position for fiscal year 2013. The balances for fiscal year 2012 have not been restated for this change. (See *Note 6* to the financial statements.) Additional information, following the *Notes to Financial Statements*, includes the combining statement of net position; the combining statement of revenues, expenses and changes in net position; as well as the combining statement of cash flows. These combining statements detail the Revolving Loan Fund, the Fees and Expense Set Aside, the Small System Technical Assistance Set Aside, the Well Head Protection Set Aside, the Capacity Development Set Aside and the State Program Management Set Aside, which comprise the Program.

Condensed Financial Information – Statements of Net Position

(In thousands)

	2014	2013 Restated	2012
Total assets	\$ <u>235,375</u>	\$ <u>219,862</u>	\$ <u>204,197</u>
Current liabilities	2,070	1,562	600
Noncurrent liabilities	<u>25,594</u>	<u>26,677</u>	<u>30,717</u>
Total liabilities	<u>27,664</u>	<u>28,239</u>	<u>31,317</u>
Net position – restricted for program requirements	\$ <u><u>207,711</u></u>	\$ <u><u>191,623</u></u>	\$ <u><u>172,880</u></u>

**State of Arkansas Safe Drinking Water
Revolving Loan Fund Program
Management's Discussion and Analysis
June 30, 2014 and 2013**

The Program's total assets have continually increased over the past three years, primarily attributed to growth in the Program's loans for water system projects. Loans receivable – restricted increased to \$167.8 million at June 30, 2014, from \$160.3 million and \$151.6 million June 30, 2013 and 2012, respectively.

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

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Loan disbursements	\$ 13,172	\$ 13,216	\$ 19,954
Loan repayments	<u>5,715</u>	<u>4,514</u>	<u>3,948</u>
Net increase in loans receivable	<u>\$ 7,457</u>	<u>\$ 8,702</u>	<u>\$ 16,006</u>

Grants from the United States Environmental Protection Agency (EPA) comprised 81%, 62% and 39% of the funding source of the loan disbursements for fiscal years ended June 30, 2014, 2013, and 2012, respectively. The table below reflects the amounts used from each funding source for fiscal years 2014, 2013 and 2012 as follows (in thousands):

	<u>2014</u>	<u>2013</u>	<u>2012</u>
EPA Federal			
Base	\$ 10,623	\$ 8,197	\$ 7,855
State Matching	2,549	5,019	4,125
Revolving Program Funds	<u>-</u>	<u>-</u>	<u>7,974</u>
	<u>\$ 13,172</u>	<u>\$ 13,216</u>	<u>\$ 19,954</u>

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

In fiscal year 2012, the Program began funding principal forgiveness loans from the Base capitalization grant as required by EPA. Each construction draw is forgiven at the time of the draw. For the fiscal years ended 2014 and 2013, the Program has awarded grants to multiple borrowers and has forgiven \$4.8 million and \$5.4 million, respectively.

The Program maintains liquidity for funding loans. The Program invested excess funds in U.S. Treasury and agencies obligations and in money market mutual funds from time to time to allow for re-evaluation of the Program's liquidity needs. Currently, the Program has \$25.0 million in investments which will mature in the fiscal year 2015.

**State of Arkansas Safe Drinking Water
Revolving Loan Fund Program
Management's Discussion and Analysis
June 30, 2014 and 2013**

At June 30, 2014, noncurrent liabilities reflected a decrease of \$1.1 million. The decrease is attributable to the decline in net bonds payable, which includes the amortization of the Series 2011 C premiums, scheduled bond redemptions and the reclassification of the amount of bonds due in fiscal year 2015. (See *Note 4* to the financial statements.)

At June 30, 2013, the decrease of \$4.0 million in noncurrent liabilities is attributable to the \$1.4 million decline in bonds payable for the amortization of the Series 2011 C premiums and the reclassification of the amount of bonds due in the fiscal year 2014 and \$2.6 million of deferred fees were recognized to net position as required with the adoption of GASB 65.

**State of Arkansas Safe Drinking Water
Revolving Loan Fund Program
Management's Discussion and Analysis
June 30, 2014 and 2013**

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

(In thousands)

	2014	2013 Restated	2012
Total interest income	\$ 3,350	\$ 3,242	\$ 2,978
Other income	<u>1,654</u>	<u>1,568</u>	<u>1,611</u>
Total operating revenues	<u>5,004</u>	<u>4,810</u>	<u>4,589</u>
Program administration	173	167	160
Federal financial assistance	4,775	5,428	303
Total interest on bonds	1,187	1,175	757
Total amortization expense	<u>(393)</u>	<u>(435)</u>	<u>(266)</u>
Total operating expenses	<u>5,742</u>	<u>6,335</u>	<u>954</u>
Operating (loss) income	(738)	(1,525)	3,635
Federal Grants	20,172	18,907	11,188
Transfers out, net	<u>(3,346)</u>	<u>(1,063)</u>	<u>(1,050)</u>
Change in net position	<u>16,088</u>	<u>16,319</u>	<u>13,773</u>
Net position			
Previously stated	191,623	172,880	159,107
Change in accounting principle	<u>-</u>	<u>2,424</u>	<u>-</u>
Restated beginning of year	<u>191,623</u>	<u>175,304</u>	<u>159,107</u>
End of year	<u>\$ 207,711</u>	<u>\$ 191,623</u>	<u>\$ 172,880</u>

Included in total interest income is interest earned on loans, which has increased to \$3.3 million for the year ended June 30, 2014, from \$3.2 million for the year ended June 30, 2013, from \$3.0 million for the year ended June 30, 2012. The attributing factor to the increase is the continuous funding of loans at a faster pace than repayments in the Program. Revenues from investments decreased to \$33,000 in the fiscal year 2014. The Program invests excess funds in U. S. Treasury and agencies obligations. The average yield on cash, cash equivalents and investments for fiscal year 2014 have increased to 0.07%; whereas the average yield for 2013 and 2012 were 0.06% and 0.02%, respectively.

**State of Arkansas Safe Drinking Water
Revolving Loan Fund Program
Management's Discussion and Analysis
June 30, 2014 and 2013**

For fiscal year 2014, operating expense declined \$593,000. The decline is primarily attributable to the decrease of federal financial assistance of \$653,000, which is offset by \$42,000 for the amortization of the bond premiums. Through Base federal funds, the Program provided forgiveness of principal loans to various municipalities for water improvements.

In comparison for fiscal year 2013, operating expenses increased \$5.4 million. The increase was attributed to a \$5.1 million increase related to the forgiveness of principal loans and a net increase of \$249,000 in bond interest expense and amortization of bond issuance costs and premiums on the Series 2011 C bonds.

For the year ended June 30, 2014, the change in net position of \$16.1 million declined \$231,000. The Program had an increase of \$1.3 million in federal grants and a decline of \$653,000 in federal financial assistance expense, which is offset by an increase in the transfers out of \$2.3 million.

For the year ended June 30, 2013, the change in net position of \$16.3 million increased \$2.5 million. The increase was primarily related to the increase in federal grants received of \$7.7 million, which was offset by the increase in federal financial assistance expense of \$5.1 million.

The Program primarily used federal grants for funding loans and paying expenses. These funds were drawn down from the federal government as expenses were incurred by the municipalities, ANRC or DOH.

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

	<u>2014</u>	<u>2013</u>	<u>2012</u>
ANRC-state match	\$ 1,274	\$ 3,305	\$ 2,512
Department of Health	(3,940)	(3,688)	(3,042)
ANRC-administration	<u>(680)</u>	<u>(680)</u>	<u>(520)</u>
Transfers out, net	<u>\$ (3,346)</u>	<u>\$ (1,063)</u>	<u>\$ (1,050)</u>

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

Contact Regarding the Program

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

State of Arkansas Safe Drinking Water Revolving Loan Fund Program

Statements of Net Position

June 30, 2014 and 2013

(In thousands)

	2014	2013 Restated
Current Assets		
Cash and cash equivalents	\$ 41,131	\$ 48,641
Accrued interest receivable	252	280
Accounts receivable		
Borrowers	131	151
Environmental Protection Agency	1,066	453
Investments – current portion	<u>25,002</u>	<u>10,001</u>
Total current assets	<u>67,582</u>	<u>59,526</u>
Noncurrent Assets		
Loans receivable – restricted		
Construction	163,818	156,273
Northeast Arkansas Public Water Authority	<u>3,975</u>	<u>4,063</u>
Total noncurrent assets	<u>167,793</u>	<u>160,336</u>
Total assets	<u>235,375</u>	<u>219,862</u>
Current Liabilities		
Accounts payable	710	464
Accrued interest payable	95	98
Bonds payable – current portion	<u>1,265</u>	<u>1,000</u>
Total current liabilities	<u>2,070</u>	<u>1,562</u>
Noncurrent Liabilities		
Bonds payable, net of unamortized premiums	<u>25,594</u>	<u>26,677</u>
Total noncurrent liabilities	<u>25,594</u>	<u>26,677</u>
Total liabilities	<u>27,664</u>	<u>28,239</u>
Net Position		
Restricted for program requirements	<u>\$ 207,711</u>	<u>\$ 191,623</u>

**State of Arkansas Safe Drinking Water
Revolving Loan Fund Program**
Statements of Revenues, Expenses and Changes in Net Position
Years Ended June 30, 2014 and 2013

(In thousands)

	2014	2013 Restated
Operating Revenues		
Interest on investments	\$ 33	\$ 39
Interest on loans	3,317	3,203
Financing fees	1,639	1,571
Net appreciation (depreciation) of investments	<u>15</u>	<u>(3)</u>
Total operating revenues	<u>5,004</u>	<u>4,810</u>
Operating Expenses		
Program administration	173	167
Federal financial assistance		
Base federal grants	4,775	5,428
Bond interest	1,187	1,175
Amortization of bond premiums	<u>(393)</u>	<u>(435)</u>
Total operating expenses	<u>5,742</u>	<u>6,335</u>
Operating Loss	<u>(738)</u>	<u>(1,525)</u>
Nonoperating Revenue		
Base federal grants	<u>20,172</u>	<u>18,907</u>
Income Before Transfers Out, Net	19,434	17,382
Transfers Out, Net	<u>(3,346)</u>	<u>(1,063)</u>
Change in Net Position	<u>16,088</u>	<u>16,319</u>
Net Position, previously reported	191,623	172,880
Change in Accounting Principle (Note 6)	<u>-</u>	<u>2,424</u>
Net Position, Restated Beginning of Year	<u>191,623</u>	<u>175,304</u>
Net Position, End of Year	<u>\$ 207,711</u>	<u>\$ 191,623</u>

State of Arkansas Safe Drinking Water Revolving Loan Fund Program

Statements of Cash Flows Years Ended June 30, 2014 and 2013

<i>(In thousands)</i>	2014	2013 Restated
Operating Activities		
Interest received on loans	\$ 3,341	\$ 3,167
Interest received on investments	35	35
Loan disbursements	(13,172)	(13,216)
Principal repayments on loans	5,715	4,514
Financing fees received	1,660	1,566
Federal grant funds expended	(4,775)	(5,428)
Cash paid for interest	(1,190)	(1,175)
Cash paid for program administration	(164)	(165)
Net cash used in operating activities	(8,550)	(10,702)
Noncapital Financing Activities		
Repayment of long term debt	(425)	-
Transfers out	(3,108)	(1,102)
Nonoperating grants received	19,559	18,829
Net cash provided by noncapital financing activities	16,026	17,727
Investing Activities		
Proceeds from maturities of investments	10,000	10,000
Purchase of investments	(24,986)	(2,000)
Net cash (used in) provided by investing activities	(14,986)	8,000
(Decrease) Increase in Cash and Cash Equivalents	(7,510)	15,025
Cash and Cash Equivalents, Beginning of Year	48,641	33,616
Cash and Cash Equivalents, End of Year	\$ 41,131	\$ 48,641
Reconciliation of Operating Loss to Net Cash Used in		
Operating Activities		
Operating loss	\$ (738)	\$ (1,525)
Items not providing operating activities cash flows		
Amortization of bond premiums	(393)	(435)
Net (depreciation) appreciation of investments	(15)	3
Changes in		
Accrued interest receivable	28	(40)
Accounts receivable – borrowers	20	(4)
Loans receivable	(7,457)	(8,702)
Accounts payable	8	1
Accrued interest payable	(3)	-
Net cash used in operating activities	\$ (8,550)	\$ (10,702)

State of Arkansas Safe Drinking Water Revolving Loan Fund Program

Notes to Financial Statements

June 30, 2014 and 2013

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

Nature of Operations and Reporting Entity

Act 772 of 1997, as amended, (the Act) authorized the establishment of a fund known as the Safe Drinking Water Fund (the Program), an enterprise fund of the State of Arkansas, to be maintained and administrated by the Arkansas Natural Resources Commission (the Commission or ANRC), formerly known as Arkansas Soil and Water Conservation Commission, and the Arkansas Department of Health. Act 1243 of 2006 authorized the name change to ANRC, which has not had an impact on the Program. The Program is to be capitalized with federal grants, state matching grants, other grants, proceeds of bonds issued by the Arkansas Development Finance Authority (ADFA) or the Commission for the Program and loan repayments utilized to administer the program. These funds may be loaned for water system projects, pledged and used to pay debt service and related costs, used to pay administrative expenses and provide technical assistance for the Program and used for other purposes related to the program.

ADFA serves as financial manager for the Program under an interagency agreement. ADFA is responsible for investing and disbursing funds as authorized by the lead agency, servicing loans, preparing and submitting monthly financial reports and annual financial statements and procuring audit services. ADFA is reimbursed for Program administration costs through a calculation based on loans outstanding in accordance with the interagency agreement. The amounts incurred to ADFA for administration costs for the years ended June 30, 2014 and 2013, were \$133,000 and \$129,000, respectively.

Use of Estimates

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

Measurement Focus, Basis of Accounting and Financial Statement Presentation

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

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

State of Arkansas Safe Drinking Water Revolving Loan Fund Program

Notes to Financial Statements

June 30, 2014 and 2013

Adoption of the New Accounting Pronouncements

In March 2012, the Governmental Accounting Standards Board issued GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. The fiscal year 2013 financial statements have been restated to reflect the implementation of the new accounting standard. (See *Note 6*.)

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, 2014 and 2013, cash equivalents of approximately \$41.1 million and \$48.6 million, respectively, consisted of money market mutual funds with variable interest rates. The maturity of the funds is considered to be less than one year because they are redeemable in full immediately.

Investments

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

Bond Premiums

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

Net Position Restricted for Program Requirements

Represents funds restricted due to the specific provisions of the Program.

Income Taxes

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

State of Arkansas Safe Drinking Water Revolving Loan Fund Program

Notes to Financial Statements

June 30, 2014 and 2013

Note 2: Deposits and Investments

Deposits

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

At June 30, 2014 and 2013, none of the Program's deposits were exposed to custodial credit risk.

Investments

Arkansas statutes authorize the Program to invest in direct obligations of the U.S. Government; obligations on which the principal and interest are fully guaranteed or are fully secured, insured or covered by commitments or agreements to purchase by the U.S. government; obligations of agencies and instrumentalities created by act of the United States Congress and authorized thereby to issue securities or evidence of indebtedness, regardless of guarantee of repayment by the U.S. government; obligations of political subdivisions of the United States; certain obligations issued by the State Board of Education; short-term warrants of political subdivisions of the State of Arkansas and municipalities; the sale of federal funds with a maturity of not more than one business day; demand, savings or time deposits fully insured by a federal deposit insurance agency; repurchase agreements that are fully insured by obligations of the U.S. government, any U.S. state or any political subdivision thereof; securities of, or other interest in, any open-end type investment company or investment trust registered under the Investment Company Act of 1940, and which is considered a money market fund, provided that the portfolio is limited principally to U.S. government obligations and the investment company or trust takes delivery of collateral either directly or through an authorized custodian; guaranteed investment contracts; and bank certificates of deposit.

State of Arkansas Safe Drinking Water Revolving Loan Fund Program

Notes to Financial Statements June 30, 2014 and 2013

At June 30, 2014 and 2013, the Program had the following investments and maturities:

(In thousands)

Type	June 30, 2014				
	Fair Value	Maturities in Years			
		Less than 1	1-5	6-10	More than 10
U. S. agencies obligations	\$ 25,002	\$ 25,002	\$ -	\$ -	\$ -
Money market mutual funds	<u>41,131</u>	<u>41,131</u>	-	-	-
Total	<u>\$ 66,133</u>	<u>\$ 66,133</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

(In thousands)

Type	June 30, 2013				
	Fair Value	Maturities in Years			
		Less than 1	1-5	6-10	More than 10
U. S. Treasury obligations	\$ 5,001	\$ 5,001	\$ -	\$ -	\$ -
U. S. agencies obligations	5,000	5,000	-	-	-
Money market mutual funds	<u>48,641</u>	<u>48,641</u>	-	-	-
Total	<u>\$ 58,642</u>	<u>\$ 58,642</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

Interest Rate Risk—As a means of limiting its exposure to fair value losses due to rising interest rates, the Program limits the maturity of investments to expected cash flow needs of the Program.

Credit Risk—Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligations. The Program's investments in U.S. agencies obligations not directly guaranteed by the U.S. government were rated "Aaa" by Moody's Investment Service, but not rated by Standard & Poor's, when owned, and its investments in money market mutual funds, or the investments of those funds were rated "AAAm" or "AAA" by Standard & Poor's and "Aaa-mf" or "Aaa" by Moody's Investors Service.

State of Arkansas Safe Drinking Water Revolving Loan Fund Program

Notes to Financial Statements

June 30, 2014 and 2013

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

Issuer	Fair Value	Percentage
Federal Home Loan Bank	\$ 25,002	38%

Summary of Carrying Values

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

<i>(In thousands)</i>	2014	2013
Carrying value		
Investments	\$ <u>66,133</u>	\$ <u>58,642</u>
Included in the following statement of net position captions		
Cash and cash equivalents	\$ 41,131	\$ 48,641
Investments – current portion	<u>25,002</u>	<u>10,001</u>
	<u>\$ 66,133</u>	<u>\$ 58,642</u>

Note 3: Loans Receivable

The Program originates loans with Arkansas municipalities for financing the construction of drinking water treatment facilities. These loans are payable in semi-annual installments. At June 30, 2014 and 2013, such loans had a carrying value of approximately \$167.8 million and \$160.3 million, respectively. The loans bear interest at 0.0% to 2.90% and are collateralized by special assessments, user charges or sales and use tax bonds issued by the municipalities.

In fiscal year 2010, the Program began funding loans with American Recovery and Reinvestment Act (ARRA) federal funds. As of June 30, 2014, the Program's outstanding loan balance for ARRA loans totaled \$22.9 million.

Through the years ended June 30, 2014 and 2013, approximately \$221.6 million and \$213.1 million in loans, respectively, had cumulatively been approved for funding. At June 30, 2014 and 2013, approximately \$19.9 million and \$27.7 million, respectively, remained encumbered and awaiting disbursement to loan recipients.

State of Arkansas Safe Drinking Water Revolving Loan Fund Program

Notes to Financial Statements June 30, 2014 and 2013

Note 4: Bonds Payable

Bonds payable were as follows at June 30:

(In thousands)

Series	Interest Rate Range	Final Maturity Dates	2014	2013
2011-C Serial	3.25% – 5.00%	6/1/2028	\$ 24,065	\$ 24,375
	Unamortized premiums		<u>2,794</u>	<u>3,302</u>
			<u>\$ 26,859</u>	<u>\$ 27,677</u>

Activity in bonds payable for 2014 was as follows:

<i>(In thousands)</i>	Beginning Balance	Additions	Reductions	Ending Balance	Amount Due within One Year
2011-C	\$ <u>24,375</u>	\$ <u>120</u>	\$ <u>(430)</u>	\$ <u>24,065</u>	\$ <u>1,265</u>

The principal amount shown above differs from the amount on the statement of net position due to unamortized premiums of approximately \$2.8 million.

Activity in bonds payable for 2013 was as follows:

<i>(In thousands)</i>	Beginning Balance	Additions	Reductions	Ending Balance	Amount Due within One Year
2011-C	\$ <u>24,375</u>	\$ <u>-</u>	\$ <u>-</u>	\$ <u>24,375</u>	\$ <u>1,000</u>

The principal amount shown above differs from the amount on the statement of net position due to unamortized premiums of approximately \$3.3 million.

State of Arkansas Safe Drinking Water Revolving Loan Fund Program

Notes to Financial Statements June 30, 2014 and 2013

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

<i>(In thousands)</i>	Principal	Interest
Fiscal Year ending June 30,		
2015	\$ 1,265	\$ 1,145
2016	1,805	1,081
2017	1,810	991
2018	1,765	901
2019	2,205	812
2020 – 2024	9,750	2,515
2025 – 2026	5,465	422
	24,065	7,876
Unamortized premiums	2,794	-
	\$ 26,859	\$ 7,867

In the current fiscal year, the Program redistributed the bond proceeds from 2011 Revolving Loan Fund Revenue Bonds, Series C (Series 2011 C) between the Program and the State of Arkansas Construction Assistance Revolving Loan Fund Program. The redistribution resulted in a net increase in bonds payable of \$5,000. The Series 2011 C was issued by both the Program and Construction Assistance Revolving Loan Fund Program. The redistribution should not have an effect on the bondholders.

In the prior fiscal year, the Program did not have any new bond issuances.

Note 5: Significant Estimates and Concentrations

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

Economic Dependency

The Program is economically dependent upon revenue from the Environmental Protection Agency (EPA). During 2014 and 2013, the Program received approximately 80% and 79%, respectively, of total revenue in the form of federal grants. The Program has fully disbursed all ARRA federal funds.

State of Arkansas Safe Drinking Water Revolving Loan Fund Program

Notes to Financial Statements

June 30, 2014 and 2013

Program Set Asides

As shown in the supplemental information, the Program has five set aside funds. These set aside funds make up 31% of the annual capitalization grant awarded each year. These funds are used to provide for reimbursement of expenses of the Program. Section 1452 of the EPA Federal Guidelines for the Implementation of Drinking Water State Revolving Loan Fund indicates a state may reserve the right to redirect unused set aside funds as eligible expenditures of the Program. Since the inception of the Program, ANRC, in conjunction with DOH, has redirected approximately \$6.3 million from previous years' capitalization grants as eligible funds for disbursement to loan borrowers.

Principal Forgiveness Loans

In fiscal year 2012, the Program began funding principal forgiveness loans (PF) with Base federal grant funds. EPA required as part of the Base capitalization grant requirements that a percentage of the grant be available as subsidy to eligible borrowers. With the federal fiscal year 2010 and 2011 capitalization grant, at least 30% of the grant would be in the form of forgiveness of principal, negative interest loans or grants. The percentage was changed to be not less than 20%, but not greater than 30% of the federal fiscal year 2012-2014 grants. To be eligible to receive subsidy, the borrower must show either:

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

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

(In thousands)

Federal Fiscal Year	Base Capitalization Grant Award	PF Minimum Amount	PF Maximum Amount	Cumulative Disbursements	PF Remaining to Disburse
2010	\$ 20,539	\$ 6,162	\$ 20,539	\$ 6,089	\$ 73
2011	14,252	4,276	14,252	3,596	680
2012	13,582	2,716	4,075	1,270	1,446
2013	12,743	2,549	3,823	-	2,549
2014	13,534	2,707	4,060	-	2,707
Totals				\$ <u>10,955</u>	\$ <u>7,455</u>

State of Arkansas Safe Drinking Water Revolving Loan Fund Program

Notes to Financial Statements

June 30, 2014 and 2013

The Program has allocated the minimum amount from each Base Capitalization grant for principal forgiveness loans. The Program forgives the loans as the construction draws are disbursed. In fiscal year 2014, \$4.8 million in principal forgiveness loans have been expensed.

Contingency

The Program is capitalized by state and federal grant programs, which are governed by various rules and regulations of the grantor agencies. Costs charged to the respective grant programs are subject to audit and adjustments by the grantor agencies; therefore, to the extent that the Program has not complied with the rules and regulations governing the grants, refunds of any money received may be required and the collectability of any related receivable at June 30, 2014 and 2013, may be impaired. In the opinion of the management of the Program, there are no significant contingent liabilities relating to compliance with the rules and regulations governing the respective grants; therefore, no provision has been recorded in the accompanying financial statements for such a contingency.

Note 6: Adoption of Accounting Standard

Effective July 1, 2012, the Program implemented GASB No. 65, *Items Previously Reported as Assets and Liabilities*. The objectives of GASB No. 65 are to (a) properly classify certain items that were previously reported as assets and liabilities as deferred outflows of resources or deferred inflows of resources and (b) recognize certain items that were previously reported as assets and liabilities as outflows of resources (expenses) or inflows of resources (revenues). In conjunction with the adoption of GASB No. 65, the Program restated beginning net position as of July 1, 2012, to expense \$181 thousand of unamortized bond issuance costs that had previously been recorded as assets of the Program and to recognize \$2.6 million of deferred loan commitment fees that had been previously recorded as liabilities of the Program. Prior to the accounting change, the bond issuance costs and the deferred loan commitment fees were amortized over the term of the bonds using the effective interest method. Loan commitment fees are now recognized when the loan commitment is exercised. The net effect of the adoption of GASB No. 65 was a decrease in change in net position for the year ended June 30, 2013, and an increase in beginning net position as of July 1, 2012 of \$144,000 and \$2.4 million, respectively.

Supplementary Information

**State of Arkansas Safe Drinking Water
Revolving Loan Fund Program
Combining Statement of Net Position
June 30, 2014**

<i>(In thousands)</i>	Small System Technical Assistance	Well Head Protection	Capacity Development	State Program Management
Current Assets				
Cash and cash equivalents	\$ -	\$ -	\$ -	\$ -
Accrued interest receivable	-	-	-	-
Accounts receivable – borrowers	-	-	-	-
Investments – current portion	-	-	-	-
Accounts receivable – EPA	<u>-</u>	<u>52</u>	<u>204</u>	<u>316</u>
Total current assets	<u>-</u>	<u>52</u>	<u>204</u>	<u>316</u>
Noncurrent Assets				
Loans receivable – restricted Construction Northeast Arkansas Public Water Authority	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total noncurrent assets	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total assets	<u>-</u>	<u>52</u>	<u>204</u>	<u>316</u>
Current Liabilities				
Accounts payable	-	52	204	316
Accrued interest payable	-	-	-	-
Bonds payable – current portion	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total current liabilities	<u>-</u>	<u>52</u>	<u>204</u>	<u>316</u>
Noncurrent Liabilities				
Bonds payable, net of unamortized premiums	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total noncurrent liabilities	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total liabilities	<u>-</u>	<u>52</u>	<u>204</u>	<u>316</u>
Net Position				
Restricted for program requirements	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

Fees and Expenses	Revolving Loan Fund	Total
\$ 6,119	\$ 35,012	\$ 41,131
3	249	252
131	-	131
-	25,002	25,002
<u>494</u>	<u>-</u>	<u>1,066</u>
<u>6,747</u>	<u>60,263</u>	<u>67,582</u>
-	163,818	163,818
<u>3,975</u>	<u>-</u>	<u>3,975</u>
<u>3,975</u>	<u>163,818</u>	<u>167,793</u>
<u>10,722</u>	<u>224,081</u>	<u>235,375</u>
138	-	710
-	95	95
<u>-</u>	<u>1,265</u>	<u>1,265</u>
<u>138</u>	<u>1,360</u>	<u>2,070</u>
<u>-</u>	<u>25,594</u>	<u>25,594</u>
<u>-</u>	<u>25,594</u>	<u>25,594</u>
<u>138</u>	<u>26,954</u>	<u>27,664</u>
<u>\$ 10,584</u>	<u>\$ 197,127</u>	<u>\$ 207,711</u>

State of Arkansas Safe Drinking Water Revolving Loan Fund Program

Combining Statement of Revenues, Expenses and Changes in Net Position Year Ended June 30, 2014

<i>(In thousands)</i>	Small System Technical Assistance	Well Head Protection	Capacity Development	State Program Management
Operating Revenues				
Interest on investments	\$ -	\$ -	\$ -	\$ -
Interest on loans	-	-	-	-
Financing fees	-	-	-	-
Net appreciation of investments	-	-	-	-
Total operating revenues	-	-	-	-
Operating Expenses				
Program administration	-	-	-	-
Federal financial assistance				
Base federal grant	-	-	-	-
Bond interest	-	-	-	-
Amortization of bond premiums	-	-	-	-
Total operating expenses	-	-	-	-
Operating Income (Loss)	-	-	-	-
Nonoperating Revenue				
Base federal grants	-	731	1,843	1,366
Total nonoperating revenue	-	731	1,843	1,366
Income Before Transfers (Out) In, Net	-	731	1,843	1,366
Transfers (Out) In, Net	-	(731)	(1,843)	(1,366)
Change in Net Position	-	-	-	-
Net Position, Beginning of Year	-	-	-	-
Net Position, End of Year	\$ -	\$ -	\$ -	\$ -

Fees and Expenses	Revolving Loan Fund	Total
\$ 1	\$ 32	\$ 33
81	3,236	3,317
1,639	-	1,639
<u>-</u>	<u>15</u>	<u>15</u>
<u>1,721</u>	<u>3,283</u>	<u>5,004</u>
171	2	173
-	4,775	4,775
-	1,187	1,187
<u>-</u>	<u>(393)</u>	<u>(393)</u>
<u>171</u>	<u>5,571</u>	<u>5,742</u>
1,550	(2,288)	(738)
<u>834</u>	<u>15,398</u>	<u>20,172</u>
<u>834</u>	<u>15,398</u>	<u>20,172</u>
2,384	13,110	19,434
<u>(1,954)</u>	<u>2,548</u>	<u>(3,346)</u>
430	15,658	16,088
<u>10,154</u>	<u>181,469</u>	<u>191,623</u>
<u>\$ 10,584</u>	<u>\$ 197,127</u>	<u>\$ 207,711</u>

**State of Arkansas Safe Drinking Water
Revolving Loan Fund Program
Combining Statement of Cash Flows
Year Ended June 30, 2014**

<i>(In thousands)</i>	Small System Technical Assistance	Well Head Protection	Capacity Development
Operating Activities			
Interest received on loans	\$ -	\$ -	\$ -
Interest received on investments	-	-	-
Loan disbursements	-	-	-
Principal repayments on loans	-	-	-
Financing fees	-	-	-
Federal grant funds expended	-	-	-
Cash paid for interest	-	-	-
Cash paid for program administration	-	-	-
	<u>-</u>	<u>-</u>	<u>-</u>
Net cash provided by (used in) operating activities	<u>-</u>	<u>-</u>	<u>-</u>
Noncapital Financing Activities			
Repayment of long term debt	-	-	-
Transfers (out) in	-	(743)	(1,800)
Nonoperating grants received	-	743	1,800
	<u>-</u>	<u>743</u>	<u>1,800</u>
Net cash (used in) provided by noncapital financing activities	<u>-</u>	<u>-</u>	<u>-</u>
Investing Activities			
Proceed from maturities of investments	-	-	-
Purchase of investments	-	-	-
	<u>-</u>	<u>-</u>	<u>-</u>
Net cash used in investing activities	<u>-</u>	<u>-</u>	<u>-</u>
Increase (Decrease) in Cash and Cash Equivalents	-	-	-
Cash and Cash Equivalents, Beginning of Year	<u>-</u>	<u>-</u>	<u>-</u>
Cash and Cash Equivalents, End of Year	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Reconciliation of Operating Income (Loss) to Net Cash Provided By (Used In) Operating Activities			
Operating income (loss)	\$ -	\$ -	\$ -
Item not providing operating activities cash flows			
Amortization of bond premiums	-	-	-
Net appreciation of investments	-	-	-
Changes in			
Accrued interest receivable	-	-	-
Accounts receivable – borrowers	-	-	-
Loans receivable	-	-	-
Accrued interest payable	-	-	-
Accounts payable	-	-	-
	<u>-</u>	<u>-</u>	<u>-</u>
Net cash provided by (used in) operating activities	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

State Program Management	Fees and Expense	Revolving Loan Fund	Total
\$ -	\$ 81	\$ 3,260	\$ 3,341
-	-	35	35
-	-	(13,172)	(13,172)
-	88	5,627	5,715
-	1,660	-	1,660
-	-	(4,775)	(4,775)
-	-	(1,190)	(1,190)
-	(162)	(2)	(164)
-	1,667	(10,217)	(8,550)
-	-	(425)	(425)
(1,160)	(1,954)	2,549	(3,108)
1,160	458	15,398	19,559
-	(1,496)	17,522	16,026
-	-	10,000	10,000
-	-	(24,986)	(24,986)
-	-	(14,986)	(14,986)
-	171	(7,681)	(7,510)
-	5,948	42,693	48,641
\$ -	\$ 6,119	\$ 35,012	\$ 41,131
\$ -	\$ 1,550	\$ (2,288)	\$ (738)
-	-	(393)	(393)
-	-	(15)	(15)
-	1	27	28
-	20	-	20
-	88	(7,545)	(7,457)
-	-	(3)	(3)
-	8	-	8
\$ -	\$ 1,667	\$ (10,217)	\$ (8,550)